207 Maximizing Insurance Coverage, Minimizing Corporate Expense

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Faculty Biographies

Scott P. DeVries

Scott DeVries is the managing partner of Nossaman, Guthner, Knox & Elliott, where he has gained tremendous insight into the multidimensional needs of organizations and applied this unique perspective to client matters and the practice of law. He directs a number of the firm's major litigation matters and personally handles strategy development, significant briefings, and oral arguments in the trial and appellate courts and client meetings. He represents a diverse range of industrial clients in the aerospace, metals, technology, energy, real estate, and chemical industries.

Mr. DeVries has more than 20 years of experience in complex civil litigation, emphasizing cases with a significant value in terms of exposure or principle to corporate clients. His experience includes high profile matters, contract litigation, with specific emphasis on insurance disputes (representing policyholders exclusively), products liability litigation, with specific emphasis on mass and class torts, and environmental actions. He also assists clients in due diligence associated with acquisitions, consults with clients engaged in major insurance and tort cases, and manuscripts complex insurance policies.

Mr. DeVries is an officer of Lighthouse of Knowledge, an organization offering seniors, children, and other community members an inviting, friendly atmosphere in which to learn about and use computers.

Mr. DeVries received his BA from William and Mary and JD from Hastings College of Law.

Peter M. Lieb

Peter M. Lieb is the associate general counsel for International Paper Company with headquarters in Stamford, CT. His responsibilities include the supervision and monitoring of all litigation, labor and employment, intellectual property, and environmental, health and safety matters affecting International Paper, and he is the acting general counsel of International Paper Company's Decorative Products Division.

Before joining International Paper, Mr. Lieb was assistant general counsel for GTE Service Corporation. Prior to that, he was a litigation partner at Jones, Day, Reavis & Pogue, where he represented corporations and individuals in federal and state civil litigation and related criminal matters. He also worked in the U.S. Attorney's office for the Southern District of New York where he prosecuted business crimes such as securities fraud and money laundering.

Mr. Lieb started his legal career with a number of federal clerkships, including clerkships for the Honorable Amalya L. Kearse, U.S. Court of Appeals, Second Circuit; and the Honorable Warren E. Burger, Chief Justice of the United States.

Mr. Lieb earned a bachelor's degree from Yale University and a law degree from the University of Michigan Law School.

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PRINCIPLES OF THIRD PARTY LIABILITY INSURANCE

By

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1. INTRODUCTION

In the 1940s, the insurance industry developed comprehensive general liability (CGL) insurance to cover a wide range of risks that businesses face. In contrast to earlier policies that only covered specifically enumerated risks or causes of loss, CGL policies covered all risks or causes except for those expressly excluded from coverage. In ensuing years, this coverage has been the subject of extensive litigation. While the CGL policy form is essentially the same throughout the country, the way in which it has been interpreted varies greatly from jurisdiction to jurisdiction. This is because insurance coverage is a matter of state and not federal law.[1]

While CGL policies have always been the subject of a considerable amount of litigation, the magnitude of cases addressing the policy language has increased multi-fold in recent years. This is directly attributable to the fact that during this period, businesses and municipalities have encountered a steadily increasing number of claims brought by federal and state environmental agencies and private parties. The claims seek relief ranging from complete remediation of soil and groundwater, to money damages for injury to person or property, to provision of lifelong medical surveillance. The potential monetary exposure of these claims is staggering. The increasing volume of claims, combined with the enormous magnitude of potential exposure on these claims, has given rise to a dramatic increase in the number of insurance disputes. These disputes are being vigorously litigated in courts throughout the country.

This chapter is intended to address the major issues that policyholders and insurance companies encounter in the area of insurance coverage for third party claims with a special emphasis on the environmental arena in light of their influence on the development of the law.

2. OVERVIEW OF THIRD PARTY LIABILITY INSURANCE COVERAGE ISSUES

Insurance is an agreement whereby one undertakes to indemnify another against loss, damage or liability arising from a contingent or unknown event. In some states insurance is defined by statute.[2] The written instrument of the contract of insurance is the policy.

§2.1 Types of Insurance Policies

§2.1.a First-party contrasted with third-party

In "first-party" policies, the insurance company agrees to indemnify the policyholder in the event the policyholder suffers a covered loss. Common forms of "first party" insurance are property, life, health, disability, fidelity and surety, and title insurance. Unlike

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1 *See* the McCarran-Ferguson Act, 15 U.S.C.A. §§ 1011 *et seq*.

2 *See, e.g.*, California Insurance Code § 22.

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liability insurance, these types of insurance are "unconcerned with establishing negligence or otherwise assessing tort liability."[3]

One common type of "first-party" insurance is referred to as "all risk" insurance. This insurance provides broad coverage for loss, injury or damage regardless of cause; any limitation on coverage is by way of exclusion. Because of the all encompassing grant of coverage, "all risk" insurance may provide coverage for pollution damage to the policyholder's own property. Under "all risk" policies, the policyholder has the burden of establishing a loss; the insurance company has the burden of proving that the loss arose from an excluded cause.[4]

Another type of "first-party" insurance is referred to as "named peril" insurance. This insurance provides coverage only for losses caused by an insured peril such as fire, lightning, vandalism or earthquake. Pollution or contamination is rarely, if ever, listed as a named peril and these policies typically will not provide coverage for this form of damage. Under these policies, the policyholder has the burden of proving that the damage was directly caused by an insured peril,[5] or that the named peril is an "efficient" proximate cause.[6]

In "third-party" policies, the insurance company agrees to indemnify the policyholder for liability to another. Two types of "third-party" policies that may provide coverage for environmental claims are comprehensive general liability ("CGL") policies, and more recently, environmental impairment liability ("EIL") policies.

CGL insurance is one of the more common forms of "third-party" liability insurance. The insurance industry developed this form of insurance in the early 1940s to meet the demand of industry that the insurance company, not the policyholder, anticipate new types of situations that might produce liabilities. Like "all risk" insurance in the "first-party" context discussed above, CGL insurance insures all risks, except those specifically excluded, instead of insuring only those risks specifically listed. The policyholder has the burden of proving that a cause of the loss comes within the scope of the insuring agreement; the insurance company has the burden of proving exclusions or limitations.[7]

The insurance industry developed EIL insurance relatively recently, in the 1970s. This insurance provides coverage for damage to the environment caused by chemical releases that were "gradual and fortuitous and neither intended nor expected by the insured."

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3 Bragg, *Concurrent Causation and the Art of Policy Drafting: New Perils for Property Insurers*, 20 Forum 385, 386 (1985).

4 *Banco Nacional de Nicaragua v. Argonaut Ins. Co.*, 681 F.2d 1337, 1339-40 (11th Cir. 1982).

5 *Lunday v. Lititz Mut. Ins. Co.*, 276 So.2d. 696, 699 (Miss. 1973).

6 *See, e.g.*, *Garvey v. State Farm Fire & Casualty Co.*, 48 Cal. 3d 395, 406, 257 Cal. Rptr. 292, 770 P.2d 704, 710 (1989).

7 *Garvey v. State Farm Fire & Casualty Co.*, 48 Cal. 3d 395, 406, 257 Cal. Rptr. 292, 770 P.2d 704, 710 (1989).

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§2.1.b Primary, excess and umbrella policies

Primary insurance is the first layer of insurance. Primary insurance policies typically contain a duty to defend.

Excess policies provide coverage for amounts of loss excess to that specified in "underlying policies" which may be at a primary or excess level. Excess policies may have wording that differs from the underlying policies, or may incorporate their wording so as to provide precisely the same scope of coverage. Excess policies that incorporate wording from underlying policies are called "following form" policies.

Umbrella policies typically provide coverage excess to several types of underlying insurance.[8] An umbrella policy also may provide coverage not provided by underlying insurance, subject only to a "self-insured" retention which may be lower than the limits of the underlying policies. This broader coverage also may incorporate a duty to defend independent of policy limits rather than merely an obligation to reimburse defense costs within limits.

As a general rule, both excess and umbrella policies condition payment upon exhaustion of applicable underlying coverage.

§2.1.c Direct insurance as distinguished from reinsurance

Direct insurance is that insurance provided by the insurance company to the policyholder. The insurance company may obtain insurance called "reinsurance," from another insurance company, the "reinsurer" who agrees to indemnify the first insurance company, "the reinsured," for losses that the reinsured may be required to pay under its agreement with the policyholder. The existence of reinsurance generally does not affect the contractual relationship between the policyholder and its insurance company.[9]

§2.1.d "Occurrence" policies as distinguished from "claims-made" policies

Occurrence policies are those policies providing coverage for "occurrences" during the policy period. A standard form definition added to policies sold after 1966 (and some policies sold previously) provides that "[a]n occurrence means an accident including a continuous or repeated exposure to conditions which results, during the policy period, in bodily injury or property damage neither expected nor intended from the standpoint of the insured."

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[8] *See, e.g., Commercial Union Ins. Co. v. Walbrook Ins. Co.*, 7 F.3d 1047, 1051 (1st Cir. 1993); *Hartford Accident and Indem. Co. v. Sequoia Ins. Co.*, 211 Cal. App. 3d 1285, 1302, 260 Cal. Rptr. 190 (1989).

[9] *See Colonial Am. Life Ins. Co. v. Commissioner of Internal Revenue*, 491 U.S. 244, 247 (1989).

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A "claims-made" policy insures only those losses or liabilities for which a claim is made against the policyholder during the policy period.[10] There are several variations of claims-made policies. One variation requires that the claim be made and reported during the policy period.[11] Jurisdictions vary on whether public policy requires claims-made policies to be construed to include a reasonable extended reporting period. Some hold that public policy so requires;[12] others hold to the contrary.[13] Another variation contains a "savings" clause which provides that claims made during a specified period (e.g., 60 days) after expiration of the policy period are deemed to have been made during the policy period.[14] Some claims-made policies permit the policyholder to purchase an extended reporting provision or "tail coverage" at the outset of or during the policy period, albeit often for substantial additional premiums.

Before 1986, CGL policies were sold primarily on an occurrence basis; since then, they have also been sold on a claims-made basis. As a general rule, EIL policies are claims-made policies.

§2.2 State Law Governs

Agreements of insurance are governed by state law, not federal law.[15] If a suit is brought in a federal court because of diversity of citizenship, the federal court applies the law of the state where the federal court sits, including that state's conflicts of law rules. This means that the law of the state in which the federal court sits may require that that federal court apply the law of a different state.

3. ENVIRONMENTAL CLAIMS IN PARTICULAR

Corporate and municipal policyholders encounter various types of environmental claims. Among the more common are those brought by federal or state governmental agencies, by individuals, or by other businesses and municipalities.

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10 *Home Ins. Co. v. Law Offices of Jonathan DeYoung, P.C.*, 32 F. Supp. 2d 219 (E.D. Pa. 1998); *Gilliam v. American Casualty Co. of Reading, PA*, 735 F. Supp. 345, 349 (N.D. Cal. 1990); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 535, n.3 (1978).

11 *Esmailzadeh v. Johnson & Speakman*, 869 F.2d 422, 425 (8th Cir. 1989).

12 *See, e.g.*, *Burns v. International Ins. Co.*, 709 F. Supp. 187, 191 (N.D. Cal. 1989), *aff'd,* 929 F.2d 1422 (9th Cir. 1991).

13 *See e.g.*, *Sletten v. St. Paul Fire & Marine Ins. Co.*, 161 Ariz. 595, 597-598, 780 P.2d 428 (1989); *Hasbouck v. St. Paul Fire & Marine Ins. Co.*, 511 N.W.2d 364, 367 (Iowa 1993); *Calocerinos & Spina v. Prudential Reinsurance Co.*, 856 F. Supp. 775 (W.D. N.Y. 1994); *St. Paul Fire & Marine Ins. Co. v. House*, 73 Md. App. 118, 134-35, 533 A.2d 301, 309 (1987), *aff'd,* 554 A.2d 404 (Md. 1989).

14 *See, e.g.*, *Calocerinos & Spina v. Prudential Reinsurance Co.*, 856 F. Supp. 775, 778 (W.D. N.Y. 1994).

15 *See, e.g.*, *Andy Warhol Foundation for Visual Arts, Inc. v. Federal Ins. Co.*, 189 F.3d 208 (2d Cir. 1999); *Indus. Indem. Ins. Co. v. United States*, 757 F.2d 982, 985 (9th Cir. 1985).

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Federal governmental agencies often proceed under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"),[16] and Resource Conservation and Recovery Act ("RCRA").[17] State governmental agencies may proceed under those acts or under state authority, such as that provided in California by the Porter-Cologne Act[18] and the Carpenter-Presley-Tanner Hazardous Substance Account Act.[19] Under these and comparable statutes, governmental agencies seek to compel potentially liable parties to clean up chemicals in soil and groundwater to background or extremely low levels. The agencies also may seek additional damages for injuries to natural resources. In turn, the potentially responsible parties ("PRPs") often seek contribution from others.

Individuals, businesses and nearby property owners bring actions, principally under state common law, alleging various forms of damages. The actions often sound in nuisance, trespass, strict liability and negligence with prayed-for relief including compensatory damages for diminution in value of property (including so-called "stigma" damages), existing physical injury, emotional distress (including so-called "cancerphobia") and medical surveillance necessitated by an allegedly material increase in the risk of future disease.[20] These claims often present financial exposure comparable to or exceeding that presented in the actions brought by governmental agencies. For example, in one case, a jury awarded $20,000 per plaintiff for each of 339 plaintiffs for lifelong medical monitoring; this award was affirmed by a higher court.[21]

4. THE DUTY TO DEFEND

§4.1 Primary as Contrasted to Excess

Primary policies generally provide a defense obligation. In contrast, excess policies may expressly exclude or include a defense obligation, or may be silent regarding that obligation. Where an excess policy "expressly and clearly" excludes, there is no obligation to contribute to defense costs; where it is silent, there is a defense obligation, albeit an obligation secondary to that of the primary insurance company, implied from the obligation to indemnify.[22]

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16 42 U.S.C. §§ 9601 *et seq.*

17 42 U.S.C. §§ 6901 *et seq.*

18 Cal. Water Code §§ 13300 *et seq.*

19 Cal. Health & Safety Code §§ 25300 *et seq.*

20 *Generally*, *see* DeVries, *Theories of Liability and Novel Claims in Toxic Tort Litigation*, Corporate Counsel's Guide to Environmental Law, 1994.

21 *Ayers v. Jackson Township*, 106 N.J. 557, 525 A.2d 287 (1987).

22 *Aetna Cas. & Surety Co. v. Certain Underwriters at Lloyd's*, 56 Cal. App. 3d 791, 800, 129 Cal. Rptr. 47 (1976).

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Traditionally, an excess insurer is not required to contribute to the policyholder's defense so long as the primary insurer is required to defend.[23] Once primary indemnity limits have been exhausted, the excess insurer will assume the duty to defend so that the policyholder will not be abandoned.[24] Some courts take a different approach, applying a pro rata or "equitable" division of defense costs as between primary and excess insurers, even before exhaustion, on the ground that the potential exposure impacts both insurers and this more equitably distributes the cost of litigation.[25]

In some instances, the primary insurer rejects the policyholder's tender of defense, an excess insurer accepts the tender and pays on the defense, and the excess insurer later seeks reimbursement from the primary insurer. Where the primary insurer is found to have owed a defense, these costs are recoverable; to hold otherwise would unfairly punish the excess insurer for performing its "secondary" duty, while unjustly enriching the primary insurer for shirking its primary obligations.[26]

§4.2 Duty to Defend Is Contained in the Insuring Agreement

The promise to provide a defense is found in the insuring agreement and is set forth separately from the promise to indemnify. By this standard form promise, the insurance company typically agrees "to defend any suit against the insured seeking damages on account of bodily injury or property damage even if any of the allegations of the suit are groundless, false or fraudulent . . . ." Because of this language, courts routinely hold that the promise to defend is separate from and broader than the promise to indemnify.[27]

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23 *National Union Fire Ins. Co. v. Travelers Ins. Co.*, 214 F.3d 1269 (11th Cir. 2000); *Hartford Accident & Indem. Co. v. Continental Nat'l Am. Ins. Cos.*, 861 F.2d 1184, 1187 (9th Cir. 1984); *Liberty Mut. Ins. Co. v. Travelers Indem. Co.*, 78 F.3d 639, 645 (D.C. Cir. 1996) *Western Alliance Ins. Co. v. Northern Ins. Co*., 968 F. Supp. 1162, 1169 (N.D. Tex. 1997).

24 *See, e.g.*, *State Farm Mut. Auto Ins. Co. v. Foundation Reserve Ins. Co.*, 78 N.M. 359, 431 P.2d 737 (1967).

25 See, e.g., *General Accident Ins. Co. v. Safety Nat'l Casualty Corp.*, 825 F. Supp. 705, 707 (E.D. Pa. 1993); *Celina Mut. Ins. Co. v. Citizens Ins. Co.*, 133 Mich. App. 655, 661, 349 N.W.2d 547, 549-50 (1984*). See also In re Wallace & Gale Co*., 275 B.R. 223 (D. Md. 2002); *U.S. Fidelity & Guar. Co. v. Federated Rural Elec. Ins. Corp*., 78 F. Supp. 2d 1176 (D. Kan. 1999); *Builders Transport, Inc. v. Ford Motor Co*., 25 F. Supp. 2d 739 (E.D. Tex. 1998).

26 *Church Mut. Ins. Co. v. Smith*, 509 N.W.2d 274, 277 (S.D. 1993).

27 *Bankwest v. Fidelity & Dep. Co*., 63 F.3d 974, 978 (10th Cir. 1995) (Kansas law); *Thom v. State Farm Lloyd's*, 10 F. Supp. 2d 693, 699-700 (S.D. Tex. 1997); *Paulin v. Fireman's Fund Ins. Co.*, 403 P.2d 555, 557-8 (Ariz. Ct. App. 1965); *Waste Management of Carolinas, Inc. v. Peerless Ins. Co.*, 315 N.C. 688, 340 S.E. 2d 374, 377 (1986); *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991); *Eichler Homes, Inc. v. Underwriters at Lloyd's of London*, 238 Cal. App. 2d 532, 538, 47 Cal. Rptr. 843 (1965).

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§4.3 Determination of Duty to Defend

The seminal case defining the scope of the duty to defend is *Gray v. Zurich Ins. Co.*[28] As the California Supreme Court stated there, an insurance company "must defend a suit which potentially seeks damages within the coverage of the policy" (emphasis added). As that Court stated subsequently in another case, "To prevail, the insured must prove the existence of a potential for coverage, while the insurer must establish the absence of any such potential."[29] Conversely, the insurance company can avoid providing a defense only where it can establish that "there is no possible factual or legal basis upon which the insurer might eventually be obligated to indemnify [the policyholder] under any provision contained in the policy."[30]

The duty to defend is determined when the third party first makes its demand against the policyholder. This is in marked contrast to the duty to indemnify, which is determined only after the policyholder's actual liability to the third party claimant is finally established.[31] This is because "it is impossible to determine the basis upon which the plaintiff will recover (if any) until the action is completed."[32] The duty to defend continues in place even if, at the end of litigation between the policyholder and the third party claimant, the policyholder's liability is established to be on grounds that are not covered.[33] "If the insurer is obliged to take up the defense of its insured, it must do so as soon as possible, both to protect the interests of the insured, and to limit its own exposure to loss."[34]

In determining whether the insurer has a duty to defend, a number of jurisdictions apply what they refer to as a "four corners of the complaint" test. Under this test, the insurance company's obligation to defend ordinarily is measured by the terms of the insurance policy and

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28 65 Cal. 2d 263, 275, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

29 *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 300, 861 P.2d 1153, 1161, 24 Cal. Rptr. 2d 467 (1993); *Aetna Casualty & Sur. Co. v. Dannenfeldt*, 778 F. Supp. 484, 495 (D. Ariz. 1991).

30 *Villa Charlotte Bronte, Inc. v. Commercial Union Ins. Co.*, 64 N.Y. 2d 846, 848, 476 N.E. 2d 640, 641 (1985); *see also Kepner v. Western Fire Ins. Co.*, 494 P.2d 749, 753 (Ariz. App. 1972), *rev'd on other grounds,* 509 P.2d 222 (Ariz. 1973) (obligation to defend unless facts "plainly take the case outside the policy coverage.")

31 *CNA Casualty of Cal. v. Seaboard Sur. Co.*, 176 Cal. App. 3d 598, 605, 222 Cal. Rptr. 276 (1986); *Waste Management of Carolinas, Inc. v. Peerless Ins. Co.*, 315 N.C. 688, 691, 340 S.E. 2d 374 (1986).

32 *Western Casualty & Surety Co. v. International Spas*, 634 P.2d 3, 6 (Ariz. Ct. App. 1981).

33 *Central Mut. Ins. Co. v. Del Mar Beach Club Owners Assoc.*, 123 Cal. App. 3d 916, 927, 176 Cal. Rptr. 895 (1981).

34 *CNA Casualty of California v. Seaboard Surety Co.*, 176 Cal. App. 3d 598, 605, 222 Cal. Rptr. 276 (1986).

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the pleading of the claimant who sues the policyholder.[35] It is immaterial that the claims later prove to be "groundless, false or fraudulent."[36]

Jurisdictions vary as to whether the allegations of the complaint control in all instances or whether, in certain instances, extrinsic evidence should be considered to create, or eliminate, a potential for coverage and consequently a defense obligation.

Some jurisdictions take a narrow view of the complaint, holding that the allegations within the "four corners of the complaint" govern; matters outside of the "four corners" always would be irrelevant. As one court has explained, this approach serves "to minimize uncertainty in assessing a liability insurer's duty, as well as to favor the insured in cases where the merits of the action may be questionable."[37]

Many jurisdictions take a more flexible approach, considering extrinsic evidence for at least some purposes.[38] Many consider this evidence where it creates a potential for coverage, reasoning that the complaint sets the minimum limits of the duty to defend.[39] Jurisdictions are divided on whether extrinsic evidence known to the insurance company also can be considered where it would have the opposite effect (*i.e.*, eliminating any potential for coverage that otherwise might exist from the face of the complaint). Some jurisdictions hold that extrinsic evidence cannot be so used.[40] Other jurisdictions hold to the contrary, reasoning:

> [W]here extrinsic evidence establishes that the ultimate question of coverage can be determined as a matter of law on undisputed facts, we see no reason to prevent an insurer from seeking summary adjudication that no potential for liability exists and thus that it has no duty to defend. We see the critical distinction as not whether extrinsic evidence may be considered,

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35 *Waste Management of Carolinas, Inc. v. Peerless Ins. Co.*, 315 N.C. 688, 691, 340 S.E. 2d 374, 377 (1986).

36 *Peerless Ins. Co. v. Strother*, 765 F. Supp. 866, 869 (E.D. N.C. 1990).

37 *Capital Bank v. Commonwealth Land Title Ins. Co.*, 861 S.W.2d 84, 87-8 (Tex. 1993).

38 *See, e.g., North Bank v. Cincinnati Ins. Cos*., 125 F.3d 983, 986 (6th Cir. 1997); *Winnacunnet Coop. Sch. Dist. v. National Union Fire Ins. Co*., 84 F.3d 32, 36-38 (1st Cir. 1996); *First Bank v. Fidelity & Deposit Ins. Co*., 928 P.2d 298, 305 (Okla. 1996). *North Bank v. Cincinnati Ins. Cos*., 125 F.3d 983, 986 (6th Cir. 1997).

39 *See, e.g.*, *Reliance Ins. Co. v. Royal Motorcar Corp.*, 534 So. 2d 922, 924, (Fla. App. 1988); *Aetna Casualty & Sur. Co. v. Freyer*, 89 Ill. App. 3d 617, 621, 411 N.E. 2d 1157 (1980); *Thornton v. Paul*, 74 Ill. 2d 132, 144, 384 N.E. 2d 335 (1978).

40 *See, e.g.*, *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y. 2d 61, 65, 575 N.E. 2d 90, 92 (1991).

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> but whether such evidence presents undisputed facts which conclusively eliminate a potential for liability.[41]

§4.4 Duty to Defend Where Multiple Causes of Action in Complaint, Some Potentially Covered, Some Not

The general rule is that if at least one cause of action potentially is covered, the insurance company must provide a defense of the entire action; it is irrelevant whether other causes of action allege facts that are not covered.[42] An exception to the general rule may exist where the insurance company produces "undeniable evidence" of the allocability of specific expenses which show the portion of defense costs attributable to defense of uncovered claims.[43] Moreover, the presence of a single "patently 'groundless' and 'shotgun' allegation" may not be sufficient to create a duty to defend an action otherwise not covered.[44]

§4.5 Duty to Defend Includes Duty to Investigate

The duty to defend necessarily encompasses the duty to investigate.[45] As a California appellate court has stated: "the defense clause promises the rendition of services requiring the insurer to investigate, conduct the defense, and at times to negotiate and make settlements."[46] This principle also has been stated thusly:

> ... the duty to defend necessarily includes any investigation necessary and proper in preparing a defense, for absent such investigation the defense of any subsequent suit filed will be seriously impaired. Therefore, where the insurer's duty to defend is in issue, its liability for the cost of a necessary and proper

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41 *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 298-99, 861 P.2d 1153, 1159-60, 24 Cal. Rptr. 2d 467 (1993). *See also Kepner v. Western Fire Ins. Co.*, 109 Ariz. 329, 331, 509 P.2d, 222, 224 (1973); *Haarstad v. Graff*, 517 N.W.2d 582, 584-85 (Minn. 1994).

42 *See, e.g.*, *U.S. v. Security Management Co., Inc*., 96 F.3d 260 (7th Cir. 1996); *Titan Holdings Syndicate v. City of Keene*, 898 F.2d 265, 269 (1st Cir. 1990); *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1081, 846 P.2d 792, 17 Cal. Rptr. 2d 210 (1993).

43 *Insurance Co. of N. Amer. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1224-25 (6th Cir. 1980), *clarified,* 657 F.2d 814 (6th Cir. 1961), *cert. denied*, 454 U.S. 1109; *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1081, 846 P.2d 792 (1993); *Buss v. Superior Court*, 16 Cal. 4th 35, 56-57 nn.18, 20, 939 P.2d 766, 775, 780-81 (1997).

44 *See, e.g.*, *George A. Fuller Co. v. U.S. Fidelity & Guar. Co.*, 200 A.D.2d 255, 259, 613 N.Y.S.2d 152, 155 (1994).

45 14 *Couch on Insurance* 2d, § 51:65 at 547 (1982).

46 *Columbia S. Chem. Corp. v. Mfrs. & Wholesalers Indem. Exch.*, 190 Cal. App. 2d 194, 205, 11 Cal. Rptr. 762, 769 (1961); *see also Pacific Indemnity Co. v. Universal Underwriters Ins. Co.*, 232 Cal. App. 2d 541, 543-44, 43 Cal. Rptr.26, 28 (1965) (duty to defend includes a duty to investigate).

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> investigation will depend on the resolution of that issue. If a trial court determines that insurer was obligated to defend its insured, then the insurer is liable for any investigative costs.[47]

These principles have been applied in an environmental context in several decisions.[48] These cases hold that the duty to defend encompasses costs included in eliminating or reducing potential damages, and that environmental investigations further that end. Using similar logic, one court has held that as a part of its duty to defend, the insurance company must pay governmental expense in overseeing an RI/FS on a policyholder's site where the policyholder agreed to pay this expense in order to pursue a cost effective remedy, thereby reducing its damages.[49]

§4.6 Notice Letters and Administrative Orders

Environmental disputes often commence with notice letters from the Environmental Protection Agency pursuant to 42 U.S.C. § 9604 or comparable state provisions, or cleanup and abatement orders or actions under 42 U.S.C. §§ 9606, 9607 or state equivalents. A dispute often arises concerning which of these events, if any, trigger the duty to defend.

The majority rule is that federal and state administrative demands satisfy the policy requirement of a "suit." Jurisdictions following this rule reason that a reasonable person would believe that these administrative demands are the "functional equivalent" of a suit; it represents the start of an adversarial proceeding which presents immediate and severe financial implications to the policyholder.[50]

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47 *Cooley v. Mid-Century Ins. Co.*, 52 Mich. App. 612, 218 N.W.2d 103 (1974).

48 *See, e.g., Aerojet-General Corp. v. Transport Indem. Co.,* 17 Cal. 4th 38, 60-68, 70 Cal. Rptr. 118 (1997); *Fireman's Fund Ins. Co. v. Ex-Cell-O Corp.*, 790 F. Supp. 1318 (E.D. Mich 1992); *Hi-Mill Manufacturing v. Aetna Casualty and Sur. Co.*, 884 F. Supp. 1109 (E.D. Mich. 1995), *aff'd*, 98 F.3d 1341 (6th Cir. 1996); *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W. 2d 724, 738 (Minn. 1997); *American Bumper and Mfg. Co. v. Hartford Fire Ins. Co.*, 550 N.W. 2d 475, 485-86 (Mich. 1996).

49 *Hi-Mill Manufacturing v. Aetna Casualty and Sur. Co.*, 884 F. Supp. 1109 (E.D. Mich. 1995); *see also Aerojet-General Corp. v. Transport Indem. Co.*, 17 Cal. 4th 38, 67-68 (prejudicially erroneous to instruct jury that such costs do not constitute defense costs).

50 *See, e.g.*, *Anderson Dev. Co. v. Travelers Indemnity Co.*, 49 F.3d 1128 (6th Cir. 1995) (Michigan law); *Aetna Casualty & Sur. Co. v. Pintlar Corp.*, 948 F.2d 1507, 1517 (9th Cir. 1991); *EDO Corp. v. Newark Ins. Co.*, 898 F. Supp. 952 (D. Conn. 1995); *Town of Windsor v. Hartford Accid. & Indem. Co.*, 885 F. Supp. 666 (D. Vt. 1995) (Vermont law); *Hutchinson Oil Co. v. Federated Serv. Ins. Co.*, 851 F. Supp. 1546, 1551 (D. Wyo. 1994); *Employers Ins. of Wausau v. Recticel Foam Corp.*, 716 N.E.2d 1015 (Ind. Ct. App. 1999); *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305 (Minn. 1995); *C.D. Spangler Constr. Co. v. Industrial Crankshaft and Eng. Co.*, 326 N.C. 133, 388 S.E.2d 557, 569 (1990); *Michigan Millers Mut. Ins. Co. v. Bronson Plating Co.*, 445 Mich. 558, 562-63, 519 N.W.2d 864, 866 (1994).

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Some jurisdictions reach a contrary conclusion, reasoning that the policy specifically refers to "lawsuits," and reading this term narrowly, conclude that it is limited to an adjudicatory proceeding in a court of law seeking damages. From this it follows (in the view of these courts) that an administrative proceeding is not a lawsuit and the insurance company has no duty to defend.[51]

§4.7 Selection of Independent Counsel

As a general rule, the insurance company must pay for independent counsel where there is a duty to defend, and an actual or potential conflict exists between the interests of the policyholder and insurance company. This principle, expressed by the California Supreme Court in *San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc.*,[52] has been adopted by statute in some jurisdictions[53] and by decisional law in other jurisdictions.[54]

The conflict must concern an issue which may arise in the underlying litigation, the outcome of which may affect coverage.[55] For example, an insurance company is not required to indemnify the policyholder if the injury sustained by a third-party was willfully caused by the policyholder. The insurance company would however have a duty to provide independent counsel because it is in the interest of the insurance company to show the injury was willfully caused, but in the interest of the policyholder to show that it was not.[56] The mere fact that a third-party seeks punitive damages against the policyholder, by itself may not create a sufficient conflict of interest between the policyholder and the insurance company to create a need for independent counsel.

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51 *See, e.g., Foster-Gardner, Inc. v. National Union Fire Ins. Co.,* 18 Cal. 4th 857, 888-889, 77 Cal. Rptr. 2d 107 (1998); *City of Edgerton v. General Cas. Co.*, 184 Wis.2d 750, 770, 517 N.W.2d 463, 473 (1994), *cert. denied*, 515 U.S. 1161, 115 S.Ct. 1360 (1995); *Ray Industries, Inc. v. Liberty Mut. Ins. Co.*, 974 F.2d 754, 761 (6th Cir. 1992); *Employers Ins. of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127, 237 Ill. Dec. 82, 708 N.E.2d 1122 (1999); *Lapham-Hickey Steel Corp. v. Protection Mut. Ins. Co.*, 155 Ill.2d 520, 655 N.E.2d 842 (1995).

52 *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc., Inc.*, 162 Cal. App. 3d 358, 375, 208 Cal. Rptr. 494 (1984).

53 *See, e.g.*, California Civil Code § 2860.

54 *See, e.g.*, *U.S. Fidelity & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 939-41 (8th Cir. 1978); *Joseph, M.D. v. Markowitz, M.D.*, 27 Ariz. App. 122, 551 P.2d 571 (1976); *Fulton v. Woodford*, 26 Ariz. App. 17, 545 P.2d 979 (1976); *National Mortgage Corp. v. American Title Ins.*, 255 S.E.2d 622 (N.C. 1979), *rev'd on other grounds*, 261 S.E.2d 844 (N.C. 1980).

55 Compare *James 3 Corp. v. Truck Ins. Exch.*, 91 Cal. App. 4th 1093, 111 Cal. Rptr. 2d 181 (2001) (a coverage dispute does not require appointment of independent counsel unless the dispute is one that will be resolved in the underlying litigation).

56 *See, e.g.*, *Blanchard v. State Farm Fire & Casualty Co.*, 2 Cal. App. 4th 345, 2 Cal. Rptr. 2d 884 (1991).

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The policyholder, not the insurance company, selects the independent counsel. But the policyholder's right may not be unlimited. As one court has observed, the right is subject to an implied covenant of good faith and fair dealing which requires selection of counsel reasonably thought to be competent to present an effective defense.[57] Some courts have held that while an insurance company may have a right to reject the policyholder's selection, that right shall not be exercised "unreasonably."[58]

Once the insurance company accepts the defense, its obligation is limited to "reasonable" fees and expense.[59] In some jurisdictions, disputes concerning reasonableness must be arbitrated.[60]

Once the insurance company accepts the duty to defend, and independent counsel is selected, the attorney-client privilege between the independent counsel and the policyholder is expanded to include the insurance company, and independent counsel is required to provide to the insurance company all information concerning the action except "privileged materials relevant to coverage disputes."[61]

Where the insurer pays for independent counsel to defend the policyholder under a reservation of rights in a suit presenting some claims that were potentially covered and others that were not, the insurer may have a right to reimbursement from the policyholder for certain defense costs.[62] In particular, the insurer may obtain reimbursement for those defense costs where it proves are allocable solely to claims for which there was never even a potential for coverage.[63]

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57 *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*, 844 P.2d 1113, 1170 (Alaska 1993).

58 *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 623, 624, 240 A.2d 397, 404 (1968).

59 *See, e.g.*, *Boyd Bros. Transp. Co. v. Fireman's Fund Ins. Cos.*, 729 F.2d 1407, 1410 (11th Cir. 1984); *Klein v. Salama*, 545 F. Supp. 175, 179 (E.D. N.Y. 1982).

60 *See, e.g.*, California Civil Code § 2860(c).

61 *See, e.g.*, California Civil Code § 2860(d).

62 Buss v. Superior Court, 16 Cal. 4th 35, 49, 939 P.2d 766, 775 (1997). *See also Colony Insurance Company v. G & E Tires & Service, Incorporated,* No. 1D00-0326, 2000 WL 1880224 (Fla. Ct. App. Dist. 1, 2000).

63 *Buss v. Superior Court*, 16 Cal. 4th 35, 52, 939 P.2d 766, 778 (1997). *See also Blue Ridge Ins. Co. v. Jacobsen* (2001) 25 Cal. 4th 489, 106 Cal. Rptr. 2d 535 (to obtain reimbursement of reasonable settlement payments on noncovered claims, the insurer must prove: (1) a timely and express reservation of rights by the insurer; (2) notice to the insured that the insurer intends to accept a proposed settlement offer; (3) the insurer's offer to allow the insured to assume the defense of the lawsuit if the insured disagrees with the terms of the proposed settlement; and (4) reasonableness of the amount paid in settlement of noncovered claims).

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§4.8 Wrongful Refusal of Defense Obligation and Burden of Proof in Ensuing Coverage Action

Where the insurance company wrongfully refuses to defend a third-party claim against the policyholder, and that claim goes to judgment against the policyholder, in an ensuing action by the policyholder against the insurance company, liability of the policyholder to the third-parties and reasonableness of damages as against the policyholder are conclusively presumed.[64] The burden is on the insurance company to prove exceptions to coverage.

Where the insurance company wrongfully refuses to defend and the third-party claim is settled, in an ensuing action by the policyholder against the insurance company, the liability of the policyholder and the reasonableness of damages against the policyholder are rebuttably presumed. The burden is on the insurance company to rebut presumptions and prove any exceptions to coverage.[65]

§4.9 Allocation of Defense Costs Among Multiple Insurance Companies with Defense Obligation

In certain circumstances, several insurance companies may be obligated to provide defense for the same loss. This occurs where a single loss extends into several policy periods, triggering the potential for coverage under successive policies, or where the risk is of such a nature that different types of insurance potentially provide coverage.

In some jurisdictions, courts have held that defense costs will be prorated among multiple insurance companies based on the relative limits of each policy.[66] Other jurisdictions apportion on a "pro rata" basis, with each insurance company bearing an equal share of the defense.[67] Others allocate among multiple insurers according to their years on the risk.[68] Yet

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64 *Isaacson v. California Ins. Guaranty Ass'n*, 44 Cal. 3d 775, 791, 750 P.2d 297, 307 (1988).

65 *Isaacson v. California Ins. Guaranty Ass'n*, 44 Cal. 3d 775, 791, 750 P.2d 297, 307 (1988).

66 *See, e.g.*, *Continental Casualty Co. v. Aetna Casualty & Sur. Co.*, 823 F.2d 708, 711 (2nd Cir. 1987).

67 *See, e.g.*, *Argonaut Ins. Cos. v. Medical Liability Mutual Ins. Co.*, 760 F. Supp. 1078, 1084-6 (S.D. N.Y. 1991).

68 *See, e.g.*, *Insurance Co. of N. Amer. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1226 (6th Cir. 1980), *clarified*, 657 F.2d 814 (6th Cir. 1981), *cert. denied*, 454 U.S. 1109 (1982); *Olin Corporation v. Insurance Company of North America*, 221 F.3d 307 (2nd Cir. 2000); *Diocese of Winona v. Interstate Fire & Cas. Co.*, 89 F.3d 1386 (8th Cir. 1996); *Public Service Co. of Colorado v. Wallis and Companies*, 986 P.2d 924 (Colo. 1999).

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others reject a single formula, instead allocating defense costs on the basis of "equitable considerations."[69]

Each insurance company is severally liable to the policyholder for the whole, subject to a right to contribution from other insurance companies.[70] This means that the policyholder need not accept partial payment on the defense from some insurers and then be compelled to file suit against recalcitrants to collect unreimbursed amounts.

§4.10 Allocation of Shared Defense Obligation to Policyholder

Once an insurance company is obligated to defend a suit, it generally is required to defend the entire suit, subject to rights of contribution from other insurers, even if a portion of the claim (such as an alternative theory of liability) is uncovered.[71] An issue arises, however, when a loss continues over several years and the policyholder is uninsured for defense in some but not all of the years. Insurance companies contend that under those circumstances the policyholder should bear a share of the defense obligation as if the policyholder were yet another insurance company. This issue is unresolved in many jurisdictions.

The seminal case finding that the policyholder is not obligated to share in defense costs is *Keene Corp. v. Insurance Company of North America*.[72] That court held that each policy from the date of first exposure to asbestos through the ultimate manifestation of a disease is triggered, and each insurance company for each of these policy years is obligated to indemnify the policyholder in full. Explaining that nothing in the policy reduces the insurance company's liability if an injury occurs only in part during a policy period, the court found that "[f]or an insurer to be only partially liable for an injury that occurred, in part, during its policy period would deprive [the policyholder] of insurance coverage for which it paid."[73] Under the same reasoning, the insurance company was obligated to pay the full defense costs incurred under a covered claim, even if the policyholder was uninsured for defense in some years.[74]

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69 *Centennial Ins. Co. v. United State Fire Ins. Co*., 88 Cal. App. 4th 105, 105 Cal. Rptr. 2d 559 (2001); *Sharon Steel Corp. v. Aetna Cas. & Sur. Co.*, 931 P.2d 127, 140 (Utah 1997). *See also Consoldiated Edison Co. v. Allstate Insurance Co.*, 2002 N.Y. Slip Op. 03419, 2002 WL 82174 (N.Y. 2002)

70 *See, e.g.*, *Haskel, Inc. v. Superior Court*, 33 Cal. App. 4th 963, 975, n.9, 39 Cal. Rptr. 2d 520, 526 (1995).

71 *E.g.*, *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1081, 846 P.2d 792, 17 Cal. Rptr. 2d 210 (1993).

72 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982).

73 667 F.2d 1034, 1049 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982).

74 667 F.2d 1034, 1050 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982). *Accord, Aerojet-General Corporation v. Transport Ind. Co.*, 17 Cal. 4th 38, 73-75, 70 Cal. Rptr. 118 (1997) (rejecting argument that defense costs should be allocated to insured, under principles of equitable contribution, for fraction of time during which insured lacked

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Insurance companies contend, and some courts have agreed, that the insurance company does not have to pay defense costs for occurrences which took place outside the policy period, and therefore should not be compelled to pay defense costs for years in which the policyholder did not purchase insurance.[75] These courts are influenced by the decision of certain policyholders to "go bare" and profess that an injustice would be done if policyholders who make such a conscious decision could reasonably expect a defense for years in which they chose to be uninsured for defense.[76] A court which adopts this viewpoint might require the policyholder to pay a share of defense costs based on various factors such as the number of years for which it was uninsured for defense.

§4.11 Insurer's Obligation to Pay Expense Incurred Before the Defense Is Tendered

The policyholder has an obligation to provide notice of potential claims or occurrences within a reasonable period of time after learning of them. Some jurisdictions strictly construe this provision, holding that the insurance company's obligation to defend does not come into existence until the policyholder tenders the defense; pre-tender expense would be a "voluntary payment" with recovery barred by the "voluntary payments" provision in the insurance policy. In these jurisdictions, issues of whether delay prejudiced the insurance company would be irrelevant.[77] This strict rule notwithstanding, pre-tender defense expense may be recoverable where the policyholder's delay in providing notice was attributed to an inability to locate the relevant insurance policies.[78]

Other courts apply a "substantial prejudice" test holding that the defense obligation exists as of the date of the claim unless the insurance company can establish that it was "substantially prejudiced" by the delay.[79]

Since excess insurers' duties to the policyholder do not arise immediately in most circumstances, greater delays in notification may be tolerated. Reasonable notice in Illinois, for

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coverage); *In re: The Wallace & Gale Co. v. The Wallace & Gale Co.*, 275 B.R. 223 (D. Md. 2002).

75 *E.g.*, *Ins. Co. of N. Amer. v. Forty-Eight Insulations*, 633 F.2d 1212 (6th Cir. 1980), *clarified*, 657 F.2d 814 (6th Cir. 1981), *cert. denied*, 454 U.S. 1109 (1981). *Accord, Morrow Corp. v. Harleysville Mut. Ins. Co.*, 101 F. Supp. 2d 422 (2000).

76 *E.g.*, *Uniroyal, Inc. v. Home Ins. Co.*, 707 F. Supp. 1368, 1392 (E.D. N.Y. 1988).

77 *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 739 (Minn. 1997), *Great American Ins. Cos. v. Aetna Casualty & Sur. Co.*, 876 P.2d 1314, 1319, 76 Haw. 346, 351 (1994).

78 *See, e.g.*, *Fiorito v. Superior Court*, 226 Cal. App. 3d 433, 438, 277 Cal. Rptr. 27, 30 (1990).

79 *See, e.g.*, *American Mutual Liability Ins. Co. v. Beatrice Companies, Inc.*, 924 F. Supp. 861 (N.D. Ill. 1996) (applying Massachusetts and Illinois law).

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example, depends upon the sophistication of the policyholder, the timing of the notice in relationship to the status of the ongoing claim or litigation, and the amount of the delay.[80]

5. THE DUTY TO INDEMNIFY

§5.1 Duty to Indemnify Is Contained in the Insuring Agreement

The promise to indemnify is found in the insuring agreement and is set forth separately from the promise to defend. By this standard form promise, the insurance company typically agrees to indemnify the policyholder for "all sums which the policyholder is legally obligated to pay as damages because of [injury to person or property]."

§5.2 Policyholder Has Burden of Proving Claim Comes Within Insuring Agreement

Most jurisdictions have held that the costs of complying with governmental orders to repair or restore groundwater are "damages" because of injury to property.[81] These jurisdictions first hold that contamination of ground or surface waters constitutes injury to property for purposes of third party liability coverage.[82] On the basis of this holding, they proceed to hold that the cost of restoring the property to its undamaged condition is one measure of compensatory property damages. These courts reason that the policyholder's right to coverage should not turn on whether the government incurred the expense and sought reimbursement, or whether it compelled the policyholder to incur the expense in the first instance.

In contrast, a small minority of courts have held that the insurance policies only cover sums paid in actions at law, not actions in equity, and the governmental actions are within

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80 *In re Celotex Corporation*, 187 B.R. 746 (M.D. Fla. 1996); *Highlands Ins. Co. v. Lewis Rail Service Co.*, 10 F.3d 1247 (7th Cir. 1993) (Illinois law).

81 *See, e.g.*, *Morton Int'l, Inc. v. General Accident Ins. Co. of Amer.*, 134 N.J. 1, 25, 27, 629 A.2d 831, 846-47 (1993), *cert. denied*, 512 U.S. 1295 (1994); *A.Y. McDonald Indus., Inc. v. Insurance Co. of N. Amer.*, 475 N.W. 2d 607, 615 (Iowa 1991); *U.S. Aviex Co. v. Travelers Ins. Co.*, 125 Mich. App. 579, 590, 336 N.W.2d 838, 843 (1983); *Farmland Indus., Inc. v. Republic Ins. Co.,* 941 S.W.2d 505 (Mo. 1997); *Lindsay Mfg. Co. v. Hartford Accident and Indem. Co.*, 118 F.3d 1263 (8th Cir. 1997).

82 *Compass Ins. Co. City of Littleton, Colo*., 984 P.2d 606 (Colo. 1999); *Travelers Indem. Co. v. Summit Corp. of Am*., 715 N.E.2d 926 (Ind. Ct. App. 1999); *Briggs & Stratton Corp. v. Royal Globe Ins. Co*., 64 F. Supp. 2d 1340 (M.D. Ga. 1999); *Monarch Greenback, LLC v. Monticello Ins. Co.,* 118 F. Supp. 2d 1068 (D. Idaho 1999); *Morrone v. Harleysville Mut. Ins. Co.*, 662 A.2d 562, 564 (N.J. Super. Ct. App. Div. 1995); *Lane Electric Coop., Inc. v. Federated Rural Elec. Ins. Corp.*, 114 Or. App. 156, 161, 834 P.2d 502, 505 (1992); *Port of Portland v. Water Quality Ins. Syndicate*, 796 F.2d 1188, 1194 (9th Cir. 1986) (applying Oregon law).

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the latter category.[83] This is because they either seek to compel the policyholder to act (for example, to restore the groundwater), or they seek reimbursement of expense that the government incurred on the policyholder's behalf, a form of restitution. In either instance, these courts hold that the expense cannot be characterized as one within the rubric of a legal obligation to pay "as damages."

In a related vein, insurers have recently started to argue that the "legally obligated to pay as damages" component of the insuring agreement restricts their obligation to instances where the trial court has ordered a payment in the underlying case. Under this approach, insurers would not have a duty to pay costs associated with an administrative action unless and until a lawsuit was filed and an order followed.

Most courts have rejected this argument.[84] As they observe, environmental response costs are damages an insured is legally obligated to pay, even when the regulatory agency issues no orders or files no lawsuit, because of the "tacit threat of formal state intervention."[85] This is consistent with the general rule of insurance policy construction which provides that insurance policies are not to be construed in a narrow, technical, literal sense; they are to be construed as a layman would do so. And a layman would not distinguish damages imposed by an administrative agency from those imposed by a court.[86]

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83 *See, Maryland Casualty Co. v. Armco, Inc.*, 822 F.2d 1348, 1354 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988); *Continental Ins. Cos. v. Northern Pharmaceutical and Chem. Co., Inc.*, 842 F.2d 977, 983-84 (8th Cir.), *cert. denied*, 488 U.S. 821 (1988) (predicting Missouri law). Maryland's Court of Appeals subsequently rejected the Fourth Circuit's reasoning, stating that damages should be defined by the ordinary layperson standard. *Hartford County v. Hartford Mut. Inc. Co.*, 327 Md. 418, 431, 610 A.2d 286, 292 (1992).

84 *See*, *e.g., Ala. Plating v. U.S. Fidelity and Guar.* (Ala. 1996) 690 So.2d 331, 336-337 (by the court); *Public Service Co. of Colorado v. Wallis* (Colo.Ct.App. 1997) 955 P.2d 564, 567-568, reversed on other grounds *sub nomine Public Service Co. v. Wallis and Companies* (Colo. 1999) 986 P.2d 924; *Bausch & Lomb v. Utica Mutual* (1993) 330 Md. 758, 780-783 [625 A.2d 1021, 1032-1034]; *SCSC Corp. v. Allied Mut. Ins. Co.* (Minn. 1995) 536 N.W.2d 305, 313; *Minnesota Min. & Mfg. v. Travelers Indem.* (Minn. 1990) 457 N.W.2d 175, 182-183; *Brown Group, Inc. v. George F. Brown & Sons* (Mo.Ct.App. 1997) 963 S.W.2d 285, 287-288; *Ryan v. Royal Ins. Co. of America*, *supra*, 916 F.2d at pages 735-743 (applying New York law); *Weyerhaeuser Co. v. Aetna Cas. and Sur.* (1994) 123 Wash.2d 891, 896-913 [874 P.2d 142, 145-154]; *Compass Ins. Co. v. Cravens, Dargan & Co.* (Wyo. 1988) 748 P.2d 724, 728; *Morrisville Water & Light Dept. v. USF&G* (D.Vt. 1991) 775 F.Supp. 718, 726-727 (applying Vermont law).

85 *Bausch & Lomb v. Utica Mutual* (Md. 1993) 625 A.2d 1021, 1030, 1032; *Minnesota Min. & Mfg. v. Travelers Indem.* (Minn. 1990) 457 N.W.2d 175, 181-182; and *Compass Ins. Co. v. Cravens, Dargan & Co.* (Wyo. 1988) 748 P.2d 724, 728

86 Generally, *see*, Section 6.1, *infra*.

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A minority of courts have, however, reached the opposite result. One of the more recent was the decision of the California Supreme Court in *Certain Underwriters at Lloyd's of London v. Superior Court (Powerine Oil Co., Inc.)*.[87] The court advanced several reasons why an insurer's obligation to pay "all sums that the insured becomes legally obligated to pay as damages" is limited to a judgment or other money ordered by a court, but the central point of analysis lay with its approach to the policy provisions. Since the defense provision expressly links "damages" to a "suit" (the insurer has a duty to defend the insured "in any suit seeking damages")—which under *Foster-Gardner, Inc. v. National Union Fire Insurance Company*[88] is limited in California to a civil action prosecuted in court—and the indemnity provision cover sums paid "as damages" (insurer "will pay all sums that the insured becomes legally obligated to pay as damages"), the court determined that "[t]he provision imposing the duty to indemnify impliedly links 'damages' to a 'suit,' … [f]or it is in a "suit" that "damages" are sought in some amount through the court's order."[89] The court also explained that the term "damages" served as a limitation on the term "legally obligated to pay" and could not be construed as a redundancy.[90]

§5.3 Insurance Companies Have Burden of Proving Exclusions and Other Limitations On Coverage

The insurance company, not the policyholder, has the burden of proving the applicability of exclusions.[91] To be enforceable, an exclusion must be [conspicuous] and "couched in words which are part of the working vocabulary of average lay persons."[92] It cannot be "submerged in a 'sea of print' nor 'inserted incidentally in a paragraph dealing with promised benefits.'"[93]

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87 24 Cal. 4th 945, 103 Cal. Rptr. 2d 672, 16 P.3d 984 (2001).

88 *Foster-Gardner, Inc. v. National Union Fire Ins. Co.*, 18 Cal. 4th 857 (1998). In *Foster-Gardner*, the court held that administrative proceedings do not trigger an obligation by insurance companies to defend "suits."

89 *Powerine*, 24 Cal. 4th at 961-962.

90 24 Cal. 4th at 963.

91 *Carter-Wallace, Inc. v. Admiral Insurance Co*., 154 N.J. 312 (1998); *Domtar, Inc. v. Niagara Fire Ins. Co*., 563 N.W.2d 724 (Minn. 1997); *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 880-81, 587 P.2d 1098, 151 Cal. Rptr. 285 (1978); *Employers Ins. of Wausau v. Duplan Corp.*, 899 F. Supp. 1112 (S.D. N.Y. 1995).

92 *Jauregui v. Mid-Century Ins. Co.*, 1 Cal. App. 4th 1544, 1550, 3 Cal. Rptr. 2d 21, 24 (1991) (*quoting Ponder v. Blue Cross of S.C.*, 145 Cal. App. 3d 709, 723 (1983)); *see also Mero v. Foster*, 206 A.D.2d 947, 948, 614 N.Y.S.2d 845, 846 (1994) (insurer wishing to exclude coverage must do so in clear and unmistakable language); *Kalmbach, Inc. v. Insurance Co. of Pa. Inc.*, 529 F.2d 552, 555 (9th Cir. 1976) (applying Alaska law).

93 *Malcolm v. Farmers New World Life Ins. Co.*, 4 Cal. App. 4th 296, 302, 5 Cal. Rptr. 2d 584 (1992) (*quoting Schmidt v. Pacific Mut. Life Ins. Co.*, 268 Cal. App. 2d 735, 737, 740, 74 Cal. Rptr. 367, 368, 370 (1969)); *see also Champion Int'l Corp. v. Continental Casualty Co.*, 400 F. Supp. 978, 981 (S.D.N.Y. 1975), *aff'd.,* 546 F.2d 502 (2d. Cir.

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§5.3.a Third-party property requirement and ownership of groundwater

CGL policies commonly contain a provision called the "owned property exclusion" which excludes coverage for property owned by the policyholder, this potentially being covered by first-party insurance. This requirement in third-party policies does not exclude coverage for injury to groundwater, whether underlying the policyholder's property or otherwise, as "the state and federal governments are third-party property owners for purposes of insurance coverage."[94] Nor does the provision exclude coverage for removal of chemicals from the soil at the policyholder's own property where required to mitigate further injury to groundwater.[95]

§5.3.b Willful acts/intended or expected damage limitation

Before 1966, CGL policies typically did not include an exclusion for injury intentionally inflicted. Instead, statutory or case law routinely implied such an exclusion into the policy.[96] However it may have been read into the policy, the insurance company bore the burden of proving that the injury was willful.[97]

In 1966, the insurance industry created a standard form occurrence policy. This form excluded coverage for injury "expected or intended from the standpoint of the insured." Many courts hold that the "intend or expect" phraseology is a limitation on coverage

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1976), wherein the court, applying New York law, comments on the need for insurance companies to avoid the risk of ambiguities by using "clear, simple and precise language which would inform insureds of the limits of their coverage."

94 *See, e.g.*, *Aerojet-General Corp. v. Superior Court*, 211 Cal. App. 3d 216, 229, 257 Cal. Rptr. 621, 629 (1988); *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 734 (Minn. 1997), *Olds-Olympic Inc. v. Commercial Union Ins. Co.*, 918 P.2d 923, 931 (Wash. 1996), *Ohaus v. Continental Casualty Ins. Co.*, 292 N.J. Super. 501, 679 A.2d 179 (App. Div. 1996); *Morrone v. Harleysville Mutual Ins. Co.*, 283 N.J. Super. 411, 662 A.2d 562 (App. Div. 1995) (groundwater not in custody or control of property owner).

95 *See, e.g.*, *Aetna Cas. & Sur. Co. v. Dow Chem. Co.*, 10 F. Supp. 2d 771 (E.D. Mich. 1998); *Ohaus v. Continental Cas. Ins. Co.*, 292 N.J. Super. 501, 679 A.2d 179 (App. Div. 1996); *Aerojet-General Corp. v. Superior Court*, 211 Cal. App. 3d 216, 226-229, 257 Cal. Rptr. 621, 628 (1988); *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 734 (Minn. 1997); *Hakim v. Mass. Ins. Insolvency Fund*, 675 N.E.2d 1161, 1164 (Mass. 1997); *Broadwell Realty Servs, Inc. v. Fidelity & Casualty Co. of N.Y.*, 218 N.J. Super. 516, 528, 528 A.2d 76, 82 (App. Div. 1987).

96 *See, e.g.*, *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 879-80, 587 P.2d 1098 (1978) (Cal. Ins. Code § 533).

97 *See, e.g.*, *Fireman's Fund Ins. Cos. v. Ex-Cell-O Corp.*, 750 F. Supp. 1340, 1350 (E.D. Mich. 1990), supplemental opinion 752 F. Supp. 812 (E.D. Mich. 1990) (applying Michigan law); *Clemco Indus. v. Commercial Union Ins. Co.*, 665 F. Supp. 816, 828 (N.D. Cal. 1987), *aff'd.,* 848 F.2d 1242 (9th Cir. 1988) (applying California law); *State Auto Mut. Ins. Co. v. McIntyre*, 652 F. Supp. 1177, 1195 (N.D. Ala. 1987) (applying Alabama law).

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and, as is true with any other limitation, the burden of proof is on the insurance company.[98] Some courts have concluded that the burden of proving that an injury is not "expected or intended" falls on the policyholder. These courts typically reason that the policyholder has the burden of proving that a loss was caused by an "occurrence" and the definition of "occurrence" includes the proposition that the injury was not expected or intended by the insured.[99]

What must be intended or expected is not the act which eventually caused the injury, but the alleged injury to third parties that is said to have ensued. The vast majority of courts in the United States hold that "in order to avoid coverage on the basis of the exclusion for expected or intentional injuries, the insurance company must demonstrate that injury itself was expected or intended."[100] The focus of the inquiry is on the "result of the act, i.e., the injury," not on the intentional nature of the act.[101]

Courts have created a narrow exception in cases where the act itself is inherently harmful such as the act of child molestation, reasoning that in this context, the act is the injury and act/injury is deemed intended. As one court has observed, "California and most other states 'infer a specific intent to injure as a matter of law from the fact of sexual misconduct with a minor.'"[102]

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98 *E.g.*, *Carter, Wallace, Inc. v. Admiral Ins. Co.*, 154 N.S. 312, 330, 712 A.2d 1116, 1126 (1998); *Aetna Cas. & Surety Co. v. Dow Chem. Co.*, 10 F. Supp. 2d 771, 798 (1998) (applying Michigan law); *Fireman's Fund Ins. Co. v. Ex-Cell-O Corp.*, 750 F. Supp. 1340, 1350 (E.D. Mich. 1990) (as amended) supplemental opinion, 752 F. Supp. 812 (E.D. Mich. 1990), *Clemco Indus. v. Commercial Union Ins. Co.*, 665 F. Supp. 816, 820, 821 (N.D. Cal. 1987).

99 *E.g., FMC Corp. v. Plaisted and Companies,* 61 Cal. App. 4th 1132, 1159, 72 Cal. Rptr. 2d 467, 483 (1998); *New Castle County v. Hartford Accident & Indemnity Co.*, 933 F.2d 1162, 1191 (3d Cir. 1991) (applying Delaware law); *Shelter Mut. Ins. Co. v. Parrish*, 659 S.W. 2d 315, 318-19 (Mo. Ct. App. 1983); *Queen City Farms v. Aetna Casualty & Sur. Co.*, 126 Wash. 2d 50, 70-71, 882 P.2d 703, 715-16 (1994), *modified*, 891 P.2d 718 (1995).

100 *Physicians Ins. Co. of Ohio v. Swanson*, 58 Ohio St. 3d 189, 190-91, 193-94, 569 N.E.2d 906, 908-11 (1991). *See also Morton Int'l, Inc. v. General Accident Ins. Co.*, 134 N.J. 1, 84-85, 629 A.2d 831, 879-80 (1993), *Gray v. Zurich Ins. Co.*, 65 C.2d 263, 273, 419 P.2d 168 (1966).

101 *Cessna Aircraft Co. v. Hartford Accident & Indemnity Co.*, 900 F. Supp. 1489, 1503 (D. Kan. 1995); *see also E&L Chipping Co. v. Hanover Ins. Co.*, 962 S.W. 2d 272, 275 (Tex. App. 1998); *Physicians Ins. Co. of Ohio v. Swanson*, 58 Ohio St. 3d 189, 191, 569 N.E.2d 906, 908-09 (1991).

102 *Morton ex rel. Morton v. Safeco Ins. Co.,* 905 F.2d 1208, 1210 (9th Cir. 1990). *See also Manufacturers and Merchants Mut. Ins. Co. v. Harvey,* 330 S.C. 152, 159, 498 S.E. 2d 222, 225 (1998); *Sena v. Travelers Ins. Co.,* 801 F. Supp. 471 (D.N.M. 1992); *Roe v. State Farm Fire & Cas. Co.*, 259 Ga. 42, 376 S.E.2d 876 (1989); *Whitt v. DeLeu*, 707 F. Supp. 1011 (W.D. Wis. 1989) (at least 15 states have adopted this application); and *J.C. Penney Casualty Ins. Co. v. M.K.*, 52 Cal. 3d 1009, 1021, 804 P.2d 689, 278 Cal. Rptr.

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One of the more important questions in evaluating insurance coverage is whether the policyholder's "intent" to cause injury is measured subjectively (that is, by evaluating what the policyholder's state of mind actually was) or, as insurance companies commonly argue, by reference to an "objective" (that is, a reasonable person) standard.

Most jurisdictions apply the subjective standard, providing coverage unless the policyholder itself intended or expected damage.[103] Some courts adopting this approach have focused on the language of the insurance policy which states that the injury must be neither expected nor intended "from the standpoint of the insured," reasoning that this requires the use of the policyholder's perspective, not that of some reasonable third party.[104] These courts reason that matters of intention and expectation are by definition subjective in nature, one court observing that "The plain meaning of 'expected' does not include 'should have known.' Rather, the word comprehends actual belief in the probability of a future event. . . . The ordinary and popular meaning of 'expect' connotes subjective knowledge of or belief in an event's probability."[105]

In contrast, several jurisdictions apply an objective, reasonable person standard. The leading case for the "objective" view is *City of Carter Lake v. Aetna Casualty & Sur. Co.*[106] Some courts adopt this approach, reasoning that a subjective test gives the policyholder too much of an "edge" in a coverage dispute. As one court explained: "Probing one's state of mind is an elusive task at best. Supplanting an objective standard with a subjective standard for determining whether the act or conduct of the insured is 'intentional' or 'expected or intended,' for purposes of assessing coverage would emasculate apposite policy provisions by making it impossible to preclude coverage for intentional acts or conduct absent admissions by

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64, *cert. denied*, 502 U.S. 902 (1991). ("[T]he intent to molest is, by itself, the same as the intent to harm.")

103 *See, e.g.*, *American Family Insurance Co. v. Walser*, 628 N.W.2d 605 (Minn. 2001); *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 748, 15 Cal. Rptr. 2d 815 (1993); *Hatco Corp. v. W.R. Grace & Co.*, 801 F. Supp. 1334, 1375-76 (D.N.J. 1992) (applying New Jersey law); *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083 (Colo. 1991); *James Graham Brown Found. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W. 2d 273, 278 (Ky. 1991); *Arco Industries Corp. v. American Motorists Ins. Co.*, 448 Mich. 395, 531 N.W.2d 168 (1995); *City of Bronson v. American States Ins. Co.*, 546 N.W.2d 702 (Mich. Ct. App. 1996); *Allstate Ins. Co. v. Freeman*, 432 Mich. 656, 443 N.W.2d 734, 737 (1989).

104 *See, e.g., Mapco Alaska Petroleum, Inc. v. Central Nat'l Ins. Co.*, 795 F. Supp. 941, 947, (D. Alaska 1991); *Hecla Mining Co. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1088 (Colo. 1991); *City of Johnstown v. Bankers Standard Ins. Co.*, 877 F.2d 1146, 1149 (2d Cir. 1989) (applying New York law).

105 *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 746, 15 Cal. Rptr. 2d 815, 834-35 (1993).

106 604 F.2d 1052 (8th Cir. 1979) (applying Iowa law).

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insureds of a specific intent to harm or injure. Human nature augers against any viable expectation of such admissions."[107]

A related issue is the level of forseeability of the injury. Courts construing the word "expect" in the phrase "neither intend nor expected" vary on whether the term is an absolute term (*viz*, expect to a certainty) or something less and if so, how much less.

The traditional formulation is that adopted by the California Supreme Court in *Clemmer v. Hartford Ins. Co.,*[108] the court holding that "an act which is intentional or willful within the meaning of traditional tort principles will not exonerate the insurer from liability . . . unless it is done with a 'preconceived design to inflict injury.'" A "specific intent to injure or harm, not merely a general intent to perform the act," is necessary to eliminate coverage.[109] Many courts apply the same standard to the latter "intend or expect" formulation."[110]

Some courts require expectation to a "substantial certainty," reasoning that "[w]here the actor knows that the harmful consequences are substantially certain to result, and proceeds with the act anyway, the law treats the actor as if the result was desired."[111] Yet others, like *City of Carter Lake v. Aetna Casualty & Sur. Co.*, bar coverage where the result merely is reasonably foreseeable,[112] essentially barring coverage for acts of negligence.

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107 *Truck Ins. Exch. v. Pickering*, 642 S.W.2d 113, 116 (Mo. 1982); *see also Chemical Leaman Tank Lines, Inc. v. Aetna Cas. & Sur. Co.*, 89 F.3d 976 (3d Cir. 1995) (applying New Jersey law); *Western Casualty & Sur. Co. v. Waisanen*, 653 F. Supp. 825, 830 (W.D. S.D. 1987).

108 22 Cal. 3d 865, 887, 587 P.2d 1098, 1110, 151 Cal. Rptr. 285, 297 (1978).

109 *Fire Ins. Exch. v. Abbott*, 204 Cal. App. 3d 1012, 1020, 251 Cal. Rptr. 620, 625 (1988).

110 *Fire Ins. Exch. v. Abbott*, 204 Cal. App. 3d 1012, 1021, 251 Cal. Rptr. 620, 625 (1988); *see also Smith v. Hughes Aircraft Co.*, 783 F. Supp. 1222, 1233-37 (D.Ariz. 1991), 22 F.3d 1432 (9th Cir. 1994), *aff'd in part, rev'd in part*, 10 F.3d 1448 (9th Cir. 1993), *amended*, 22 F.3d 1432 (9th Cir. 1993), *American Nat'l Fire Ins. Co. v. B&L Trucking & Constr. Co.*, 920 P.2d 192, 198 (Wash. 1996) (because insurer only agreed to pay for damages insured was "legally obligated" to pay, relevant question for occurrence and pollution exclusion was when insured expected contamination as a result of arsenic leaching from slag, not when insured expected any contamination from site), *aff'd*, 951 P.2d 250 (1998); *American Bumper and Mf'g Co. v. Hartford Fire Ins. Co.*, 550 N.W.2d 475, 483 (Mich. 1996) ("We find it difficult to believe that [the insured] 'expected or intended' that its apparently lawful use of the seepage lagoon would result in property damage requiring remediation").

111 *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 742, 15 Cal. Rptr. 2d 815, 832 (1993); *see, Carter-Wallace, Inc. v. Admiral Ins. Co.*, 154 N.J. 312, 334, 712 A.2d 1116, 1127 (1998).

112 604 F.2d 1052, 1057 (8th Cir. 1979) (applying Iowa law).

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Where the policyholder is an individual, it is the individual's intent and expectation which is at issue. Where the policyholder is a corporation, there is a dispute concerning whose intent governs. Policyholders assert that it is the corporate intent, *viz.*, that of an officer, director or managing agent of the corporation; insurance companies assert that it is the intent or expectation of each employee.[113]

§5.3.c The 1970 "sudden and accidental" pollution exclusion and the 1985 "absolute" pollution exclusion

In 1970, the insurance industry drafted a "pollution exclusion" for inclusion in CGL policies. The clause states that the policy:

> does not apply to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water, but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.

Most CGL policies issued in and after 1970 contain an exclusion either identical or similar to this "sudden and accidental" pollution exclusion.

Many jurisdictions hold that the term "sudden" is ambiguous, and does not materially affect the scope of coverage provided by the CGL policy.[114] These courts typically rely upon the drafting history of the Insurance Services Office ("ISO") and its predecessor entities, and submissions by the insurance industry to state insurance commissioners.[115] One of

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113 *See, e.g., FMC Corp. v. Plaisted and Companies*, 61 Cal. App. 4th 1132, 1212-1213 (1998).

114 *E.g., In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d 456 (D.V.I. Nov. 29, 1999); *St. Paul Fire & Marine Ins. Co. v. Lefton Iron & Metal Co.*, 296 Ill. App. 3d 475, 486, 694 N.E.2d 1049, 1057 (1998); *Hudson v. Farm Family Mutual Insurance Co.*, 697 A.2d 501 (N.H. 1997); *American States Insurance Co. v. Kiger*, 662 N.E.2d 945 (Ind. 1996); *St. Paul Fire & Marine Insurance Co. v. McCormick & Baxter Creosoting Co.*, 923 P.2d 1200 (Or. 1996).

115 *See, e.g.*, *Textron, Inc. v. Aetna Casualty & Surety Co.*, 754 A.2d 742 (R.I. 2000); *Alabama Plating Co. v. U.S. Fid. & Guar. Co.*, 690 So. 2d 331 (Ala. 1996), *Hecla Mining Corp. v. New Hampshire Ins. Co.*, 811 P.2d 1083, 1092 (Colo. 1991), *New Castle County v. Hartford Accident and Indem. Co.*, 933 F.2d 1162, 1198-99 (3d Cir. 1991) (interpreting Delaware law); *Associated Scrap Metal Inc. v. Royal Globe Ins. Co.*, 927 F. Supp. 432 (S.D. Ala. 1995) (applying Alabama law), *aff'd*, 127 F.3d 37 (11th Cir. 1997); *Greenville County v. Insurance Reserve Fund*, 443 S.E. 2d 552 (S.C. 1994); *Claussen v. Aetna Casualty & Sur. Co.*, 259 Ga. 333, 335, 380 S.E.2d 686, 688 (1987); *Patz v. St. Paul Fire & Marine Ins. Co.*, 15 F.3d 699, 703 (7th Cir. 1994) (interpreting Wisconsin

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the more recent decisions is *Queen City Farms, Inc. v. Central Nat'l Ins. Co.*,[116] in which the Washington Supreme Court concluded that "sudden" does not necessarily have a temporal context. Among other factors, the court relied upon the interpretation of "sudden and accidental" in boiler and machinery policies.[117] As Couch elaborates, courts have long recognized that under boiler and machinery policies "[w]hen coverage is limited to a sudden 'breaking' of machinery, the word 'sudden' should be given its primary meaning as a happening without previous notice, or as something coming or occurring unexpectedly, as unforeseen or unprepared for. That is, 'sudden' is not to be construed as synonymous with instantaneous."[118] Another court, the Supreme Court of New Jersey in *Morton Int'l, Inc. v. General Accident Ins. Co. of Am.*, found that while the pollution exclusion is clear, the history of the insurance industry's marketing and regulatory activities estops insurance companies from taking a position contrary to that which was taken by them or on their behalf in 1970.[119]

Decisions holding otherwise typically disregard drafting history.[120] These courts conclude that the provision is unambiguous and that, taken in context, the term "sudden" must mean abrupt in order to have some meaning different from "accidental" in the phrase "sudden and accidental."[121]

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law); *Just v. Land Reclamation Ltd.*, 155 Wis. 2d 737, 741-42, 157 Wis.2d 507, 456 N.W.2d 570, 571-72 (1990); *American States Ins. Co. v. Kiger*, 662 N.E.2d 945 (1996); *St. Paul Fire & Marine Ins. Co. v. McCormick & Baxter Creosoting Co.*, 324 Or. 184, 923 P.2d 1200 (1996). *See also Weaver v. Royal Ins. Co. of America*, 140 N.H. 780, 674 A.2d 975 (1996) (transporting of lead dust via automobile may not be a "discharge, dispersal, release or escape" of a pollutant); *Bituminous Casualty Co. v. Advanced Adhesive Technology Inc.*, 73 F.3d 335 (11th Cir. 1996) ("sudden" means "unexpected," but drafting history inadmissible).

116 126 Wash.2d 50, 882 P.2d 703 (1994).

117 126 Wash.2d 50, 80, 882 P.2d 703, 720; *Anderson & Middleton Lumber Co. v. Lumbermen's Mut. Casualty Co.*, 53 Wash.2d 404, 333 P.2d 938 (1959).

118 10A *Couch on Insurance* 2d § 42:396 at 505 (1982).

119 134 N.J. 1, 89, 629 A.2d 831, 881 (1993). *Accord, Sunbeam Corp. v. Liberty Mutual Ins. Co*., 781 A.2d 1189 (Pa. 2001). *Cf. Anderson v. Minnesota Ins. Guaranty Assoc.*, 534 N.W.2d 706 (Minn. 1995) (rejecting estoppel argument); *Cessna Aircraft Co. v. Hartford Accid. & Indem. Co.*, 900 F. Supp. 1489 (D. Kan. 1995) (same).

120 *Buell Industries, Inc. v. Greater New York Mutual Insurance Co*., 259 Conn. 527, 2002 WL 234779 (Conn. 2002); *Hyde Athletic Inds. v. Continental Cas. Co.*, 969 F. Supp. 289, 304 n. 14 (E.D. Pa 1997) ("most courts either have not considered the regulatory history of the pollution clause in determining its meaning or have held that the history of the pollution exclusion clause does not support a finding of industry deception.")

121 *E.g., Liberty Mutual Ins. Co. v. Fry Bearings Corp.*, 153 F.3d 919, 923 (8th Cir. 1998) (purporting to apply Missouri law); *FMC Corp. v. Plaisted and Companies*, 61 Cal. App. 4th 1132, 1146 (1998); *North Pacific Ins. Co. v. Mai*, 939 P.2d 570 (Idaho 1997); *Northville Inds. Corp. v. Nat. Union Fire Ins. Co.*, 679 N.E.2d 1044 (N.Y. App. 1997); *Iowa Comprehensive Petroleum Underground Storage Tank Board v. Farmland Mut. Ins.*

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Courts are divided on who bears the burden of proving that any discharge was "sudden and accidental." Some courts hold that the policyholder has the burden of proving exceptions to an exclusion. These courts generally acknowledge that the insurance company has the burden of proving exceptions to coverage, but hold that because of the structure of the pollution exclusion, the burden of bringing a claim within the scope of an exception to an exclusion should be the same as the burden for bringing the claim within the scope of coverage in the first instance.[122]

In contrast, a number of jurisdictions place the burden of disproving that the discharge was "sudden and accidental" on the insurance company. These courts reason that

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Co., 588 N.W.2d 815 (1997) (Iowa law); *Mesa Oil, Inc. v. Ins. Co. of North America* 123 F.3d 1333 (10th Cir. 1997) (finding statements made to regulators do not render the pollution exclusion ambiguous under New Mexico law); *Federated Mutual Ins. Co. v. Botkin Group*, 64 F.3d 537 (10th Cir. 1995) (applying Kansas law); *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 755-56, 15 Cal. Rptr. 2d 815, 841 (1993); *ACL Technologies v. Northbrook Property & Casualty Ins. Co.*, 17 Cal. App. 4th 1773, 1777, 22 Cal. Rptr. 2d 206, 207 (1993); *Mustang Tractor & Equipment Co. v. Liberty Mutual Ins. Co.*, 76 F.3d 89 (5th Cir. 1996) (applying Texas law); *Smith v. Hughes Aircraft Co.*, 22 F.3d 1432 (9th Cir. 1994) (interpreting California and Arizona law); *United States Fidelity & Guar. Co. v. Star Fire Coals, Inc.*, 856 F.2d 31, 34 (6th Cir. 1988) (applying Kentucky law); *Landauer, Inc. v. Liberty Mut. Ins. Co.*, 36 Mass. App. Ct. 177, 628 N.E.2d 1300 (1994); *Heyman Assocs. No. 1 v. Insurance Co. of Pa.,* 231 Conn*.,* 756, 653 A.2d 122 (1995); *Auto Owners Ins. Co. v. City of Clare*, 446 Mich. 1, 521 N.W.2d 480 (1994); *Board of Regents v. Royal Ins. Co.*, 517 N.W.2d 888 (Minn. 1994); *Gould, Inc. v. CNA*, 809 F. Supp. 328 (M.D. Pa. 1982) (applying Pennsylvania law); *Drexel Chemical Co. v. Bituminous Ins. Co.*, 933 S.W.2d 471 (Tenn. Ct. App. 1996); *American Mutual Liability Ins. Co. v. Beatrice Companies, Inc.*, 924 F. Supp. 861 (N.D. Ill. 1996) (applying Massachusetts law); *Cessna Aircraft v. Hartford Acc. & Indem. Co.*, 900 F. Supp. 1489 (D. Kan. 1995) (applying Kansas law).

122 *E.g.*, *Golden Eagle Refinery Co., Inc. v. Associated Int'l Ins. Co.*, 85 Cal. App. 4th 1300, 102 Cal. Rptr. 2d 834 (2001) (insured must also prove the extent to which any sudden and accidental discharge caused the contamination for which coverage is sought); *Travelers Cas. & Sur. Co. v. Superior Court*, 63 Cal. App. 4th 1440, 1455, 75 Cal. Rptr. 2d 54, 63 (1998); *Northville Inds. Corp. v. Nat. Union Fire Ins. Co.*, 679 N.E.2d 1044 (N.Y. App. 1997); *Aydin Corp. v. First State Ins. Co.*, 18 Cal. 4th 1183 (1998); *Highlands Ins. Co. v. Aerovox, Inc.,* 676 N.E.2d 801 (Mass. 1997); *Harrow Products, Inc. v. Liberty Mutual Ins. Co.*, 64 F.3d 1015 (6th Cir. 1995) (interpreting Michigan law); *Aeroquip Corp. v. Aetna Casualty & Sur. Co.*, 26 F.3d 893, 895 (9th Cir. 1994) (interpreting California law); *American States Ins. Co. v. Estate of Abbas Bakhtiary*, 1995 WL 748060 (N.D.Cal. 1995) (interpreting California law); *Hudson Ins. Co. v. Double D Management Co.*, 768 F. Supp. 1542, 1545 (M.D. Fla. 1991) (interpreting Florida law); *Interex Corp. v. Atlantic Mut. Ins. Co.*, 874 F. Supp. 1406, 1417 (D. Mass. 1995) (interpreting Massachusetts law); *Upjohn Co. v. Aetna Casualty & Sur. Co.*, 850 F. Supp. 1342, 1346 (W.D. Mich. 1993) (interpreting Michigan law); *SCSC Corp. v. Allied Mutual Ins. Co.*, 536 N.W.2d 305 (Minn. 1995).

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the policyholder has already satisfied its burden of bringing the claim within the scope of coverage even though the policyholder has not addressed the pollution exclusion or exceptions to that exclusion. The exclusion should be treated as a coherent whole and the burden of proving an exclusion from coverage continues to fall upon the insurance company.[123] These cases recognize the principle established elsewhere in insurance law that "the insurer in proving that the loss comes within the exception must also proceed further to show that the exception or limitation to the exception does not preclude application of the exception."[124] Even jurisdictions which place the burden on the policyholder for purposes of determining indemnity may require the insurer to disprove any potential coverage before relieving the insurer of its obligation to defend.[125]

Several courts have addressed the question of what event or occurrence must be "sudden and accidental." Some courts have held that it is the initial discharge that is relevant.[126] Thus, regular and ongoing discharges as part of a normal operation, even when the insured had no knowledge that the discharges were polluting or could pollute the environment, are not "sudden."[127] This focus on the initial discharge would preclude any liability coverage for discharges into approved facilities such as landfills, even if a third party was responsible for waste disposal.[128] Other courts hold that it is the migration out of the facility into which the

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123 *EDO Corp. v. Newark Ins. Co.*, 878 F. Supp. 366, 371 (D. Conn. 1995) (interpreting Connecticut law); *Continental Ins. Co. v. Beecham, Inc.*, 836 F. Supp. 1027, 1042 (D. N.J. 1993) (interpreting New Jersey law).

124 19 *Couch on Insurance* 2d § 79:385 at 338 (1983).

125 *New Coleman Holdings Inc. v. Aetna Cas. & Surety Co.*, 1995 WL 708684 (D. Kan. 1995).

126 *See, e.g.*, *LaFarge Corp. v. Travelers Indem. Co.*, 118 F.3d 1511 (11th Cir. 1997) (Florida law); *Hinds v. Clean Land Air Corp.*, 693 So. 2d 321 (La. App. 1997); *Broderick Inv. Co. v. Hartford Acc. & Ind. Co.*, 954 F.2d 601 (10th Cir. 1992) (interpreting Colorado law); *Kerr-McGee Corporation v. Admiral Ins. Co.*, 905 P.2d 760 (Okla.), *cert. denied*, 506 U.S. 865 (1995).

127 *E.g.*, *Travelers Cas. & Sur. Co. v. Superior Court*, 63 Cal. App. 4th 1440, 1459, 75 Cal. Rptr. 2d 54, 66 (1998); *Virginia Properties Inc. v. Home Ins. Co.*, 74 F.3d 1131 (11th Cir., 1996) (applying Georgia law); *Transamerican Ins. Co. v. Duro Bag Manufacturing Co.*, 50 F.3d 370 (6th Cir. 1995) (applying Kentucky law); *Bell Lumber & Pole Co. v. United States Fire Ins. Co.*, 60 F.3d 437 (8th Cir. 1995) (applying Minnesota law); *Grant S. Iron & Metal Co. v. CNA Ins. Co.*, 905 F.2d 954, 957 (6th Cir. 1990); *EDO Corporation v. Newark Ins. Co.*, 878 F. Supp. 366 (D. Conn. 1995); *Drexel Chemical Co. v. Bituminous Ins. Co.*, 933 S.W.2d 471 (Tenn. Ct. App. 1996); *Gold Fields American Corp. v. Aetna*, No. 19879/89 (N.Y. Sup. Ct. Mar. 28, 1996) (applying New York law and purporting to apply Missouri law), *reported in* 10 Mealey's Ins. Litig. Rep. at B-6 (1996).

128 *See, e.g.*, *Broderick Inv. Co. v. Hartford Acc. & Ind. Co.*, 954 F.2d 601 (10th Cir. 1992) (interpreting Colorado law); *LaFarge Corp. v. Travelers Indemnity Co.*, 927 F. Supp. 1534 (M.D. Fla. 1996); *aff'd* 118 F.3d 1511 (M.D. Fl. 1996).

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chemicals were discharged, whether it be leakage from a tank or a landfill, that is relevant. These cases reason that the pollution exclusion should be applied to the event that causes injury, not to some earlier event which is irrelevant from the claimant's viewpoint.[129]

Several courts have addressed the standard for evaluating intent in conjunction with the "sudden and accidental" exception to the pollution exclusion. One court concluded that "the insured's action must be analyzed under an objective rather than subjective standard," reasoning that the "sudden and accidental" exception "'unambiguously links the terms "sudden and accidental" with the release as opposed to the knowledge, intent, or expectation of the insured.'"[130] Other courts reject this reasoning, instead focusing on whether the policyholder itself expected a discharge to the environment and resulting environmental damage.[131] One court has framed the test as requiring subjective intent to cause environmental harm unless "exceptional circumstances" support a presumption of the insured's intent to damage the environment.[132]

Since the pollution exclusion does not apply to coverage for "personal injury," which includes the "wrongful entry or eviction or other invasion of the right of private occupancy," some insureds have argued that failure to properly dispose of pollutants which causes the "wrongful entry" of those pollutants onto land or into water fall within that coverage. A few courts have so held.[133] Many courts have rejected this argument, reasoning that the personal injury coverage only applies to injuries to persons, not injury to property.[134]

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129 *See, e.g.*, *Bell Lumber & Pole Co. v. United States Fire Ins. Co.*, 60 F.3d 437 (8th Cir. 1995) (applying Minnesota law); *New Castle County v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1203 (3d Cir. 1991) (applying Delaware law); *Sylvester Bros. Dev. Co. v. Great Central Ins. Co.*, 480 N.W.2d 368, 374 (Minn. Ct. App. 1992); *Union Pacific Resources Co. v. Aetna Casualty & Sur. Co.*, 894 S.W.2d 401, 404 (Tex. App. 1994).

130 *Traverse City Light & Power Board v. Homes, Ins. Co.*, 209 Mich. App. 112, 119, 530 N.W.2d 150, 153 (1995) (*quoting Matakas v. Citizens Mut. Ins. Co.*, 202 Mich. App. 642, 653, 509 N.W.2d 898 (1993)); *see also Queen City Farms v. Central Nat'l Ins. Co.*, 126 Wash.2d 50, 882, P.2d 703, 723-24 (1994); *Quaker State Minit-Lube v. Fireman's Fund Ins. Co.*, 52 F.3d 1522, 1531 (10th Cir. 1995) (applying Utah law).

131 *See, e.g.*, *Key Tronic Corp. v. Aetna Fire Underwriters Ins., Co.*, 124 Wash.2d 618, 628, 881 P.2d 201, 208 (1994).

132 *Morton Int'l. Inc. v. General Acc. Ins. Co.*, 629 A.2d 831, 879-84 (N.J. 1993), *cert. denied*, 512 U.S. 1245, 114 S.Ct. 2764 (1994); *accord*, *Chemical Leaman Tank Lines Inc. v. Aetna Casualty & Surety Co.*, 89 F.3d 976 (3d Cir. 1996). *See also J. Josephson, Inc. v. Crum & Forster Ins. Co.*, 679 A.2d 1206 (N.J. Super. 1996) (Coverage not barred unless insured and third party waste hauler conspired to intentionally discharge known pollutants illegally or improperly.)

133 *E.g.*, *Great Northern Nekoosa Corp. v. Aetna Casualty & Surety Co.*, 921 F. Supp. 401 (N.D. Miss. 1996) (trespass and nuisance claims of property owners are personal injury not within pollution exclusion under Mississippi law); *Millers Mutual Ins. Assoc. of Illinois v. Graham Oil Co.*, 668 N.E.2d 223 (Ill. App. Ct. 1996); *City of Edgerton v.*

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In 1985, the insurance industry created a broader so-called "absolute" version of the pollution exclusion. It typically excludes coverage for:

> (1) "bodily injury," "property damage," or injury or damage of any nature or kind to persons or property arising out of the actual, alleged or threatened emission, discharge, dispersal, seepage, release or escape of "pollutants"; (2) any loss, cost, or expense incurred as a result of any clean-up of "pollutants"; or (3) the investigation, settlement or defense of any claim, "suit" or proceeding against the insured, including any payments, cost or expenses associated herewith, alleging such injury, damage, loss, cost or expense as described in (1) and (2) above.

As the Tenth Circuit observed in *Red Panther Chem. Co. v. Insurance Co. of Pa.*[135]: various courts have found this provision to be "clear" and unambiguous and "susceptible of only one possible interpretation."[136] As one court has stated: "This pollution exclusion is just what it purports to be—absolute...."[137]

General Casualty Co., 172 Wis.2d 518, 493 N.W.2d 768 (Ct. App. 1992), *rev'd in part on other grounds*, 184 Wis.2d 750, 517 N.W.2d 463 (1994).

134 *E.g.*, *Dryden Oil Company of New England Inc. v. Travelers Indemnity Co.*, 91 F.3d 278 (lst Cir. 1996) (applying Massachusetts law); *City of Delray Beach v. Agricultural Ins. Co.*, 85 F.3d 1527 (11th Cir. 1996) (applying Florida law); *Harrow Products v. Liberty Mutual Ins. Co.*, 64 F.3d 1015 (6th Cir. 1995) (applying Michigan law); *A. J. Gregory v. Tennessee Gas Pipeline Co.*, 948 F.2d 203 (5th Cir. 1991) (applying Louisiana law); *Bituminous Casualty Co. v. Kenworthy Oil Co.*, 912 F. Supp. 238 (W.D. Tex. 1996), *aff'd,* 105 F.3d 656 (5th Cir. 1996); *Whiteville Oil Co. v. Federated Mutual Ins. Co.*, 889 F. Supp. 241 (E.D.N.C. 1995), *aff'd*, 87 F.3d 1310 (4th Cir. 1996); *Titan Corp. v. Aetna Casualty & Surety Co.*, 22 Cal. App. 4th 457, 27 Cal. Rptr. 2d 476 (1994). *See also Robert E. Lee & Assoc. v. Peters*, 557 N.W.2d 457 (Wis. App. 1996).

135 43 F.3d 514, 518 (10th Cir. 1994).

136 *National Union Fire Ins. Co. v. CBI Indus.*, 907 SW 2d 517 (Tex. 1995). *See also Wagner v. Erie Insurance Company*, 2002 PA Super 166, 2002 WL 1023106 (2002); *Kim v. State Farm Fire and Cas. Co*., 728 N.E. 2d 530 (Ill. App. 2000); *Deni Associates of Florida, Inc. v. State Farm Fire & Cas. Co.,* 711 So.2d 1135, 1137 (Fla. 1998); *Kimber Petroleum Corp. v. Travelers Indemnity Co.*, 689 A.2d 747, *cert. denied,* 695 A.2d 669 (N.J. 1997) (under New Jersey law, representations made by insurance industry officials to state regulators about scope of "absolute" pollution exclusion did not require exclusion to be interpreted against its plain language under Morton "regulatory estoppel" doctrine); *Dryden Oil Company of New England Inc. v. Travelers Indemnity Co.*, 91 F.3d 278 (lst Cir. 1996) (applying Massachusetts law); *American States Ins. Co. v. Nethery*, 79 F.3d 473 (5th Cir. 1996) (applying Mississippi law); *Larsen Oil Co. v. Federated Service Ins. Co.*, 859 F. Supp. 434, 437 (D. Or. 1994), *aff'd*, 70 F.3d 1279 (9th Cir. 1995) (applying Oregon law); *Bituminous Casualty Corp. v. RPS Co.*, 915 F. Supp. 882 (W.D. Ky. 1996) (applying Kentucky law); *Production Stamping Corp. v. Maryland Casualty Co.*, 199 Wis. 2d 322, 544 N.W.2d 584 (1996) (applying Wisconsin law); *Heyman Assocs. No. 1 v.*

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Some courts have, however, identified several contexts in which the exclusion does not bar coverage.[138] Some reach this result by finding that the chemical at issue was not a "pollutant," or that the discharge cannot reasonably be deemed "environmental pollution" for purposes of this exclusion.[139] This approach has been used to extend coverage to personal injuries arising from a routine application of pesticides, one court reasoning that:

> [t]he terms "irritant" and "contaminant" ... cannot be read in isolation, but must be construed as substances generally recognized as polluting the environment. They must occur in a setting such that they would be recognized as a toxic or particularly harmful substance in industry or by governmental regulators.[140]

Insur. Co. of Pa., 231 Conn. 756, 769-76, 653 A.2d 122, 130-33 (1995); *Constitution State Ins. Co. v. Iso-Tex Diagnostics, Inc.*, 61 F.3d 405, 410, (5th Cir. 1995); *Bureau of Engraving v. Federal Ins. Co.*, 793 F. Supp. 209, 212 (D.Minn. 1992), *aff'd*, 5 F.3d 1175 (8th Cir. 1993); *Whiteville Oil Co. Inc. v. Federated Mutual Ins. Co.*, 889 F. Supp. 241 (E.D.N.C. 1995), *aff'd* 87 F.3d 1310 (4th Cir. 1996); *Titan Corp. v. Aetna Casualty & Sur. Co.*, 22 Cal. App. 4th 457, 470, 27 Cal. Rptr. 2d 476, 482 (1994).

137 *Alcolac Inc. v. California Union Ins. Co.*, 716 F. Supp. 1546, 1549 (D.Md. 1989).

138 *See, e.g. Keggi v. Northbrook Property & Casualty Insurance Co*., 13 P.3d 785 (Ariz. Ct. App. 2000) (so-called absolute pollution exclusion does not apply to injuries caused by bacteria-contaminated water); *Doerr v. Mobil Oil Corp*., 774 So. 2d 119 (La. 2000) (explaining literal reading of the total pollution exclusion would lead to absurd results).

139 *E.g.*, *S.N. Golden Estates, Inc. v. Continental Cas. Co.*, 680 A.2d 1114 (N.J. Super. 1996) (pollution exclusion did not apply to damage caused by failure of septic tanks); *American States Ins. Co. v. Kiger*, 662 N.E.2d 945 (1996) (Indiana law); *Perry v. Economy Fire & Cas. Co*., 311 Ill. App. 3d 69, 243 Ill. Dec. 842, 724 N.E.2d 151 (1st Dist. 1999). *But see Brown v. American Motorists Ins. Co.*, 930 F. Supp. 207 (E.D. Pa. 1996) (fumes from waterproofing sealant on exterior of house are "pollutants"), *aff'd*, Ill. F.3d 125 (3rd Cir. 1997), *cert. denied*, 118 S.Ct. 369 (1997); *Cook v. Evanson*, 920 P.2d 1223 (Wash.App. 1996) (exclusion reached routine workplace torts and was not limited to traditional environmental damage, therefore exclusion precluded coverage for respiratory injuries sustained when fumes from concrete sealant entered building).

140 *Westchester Fire Ins. Co. v. City of Pittsburg*, 768 F. Supp. 1463, 1470-71 (D. Kan. 1991). *But see United National Insurance Company v. Airosol Company, Inc*., 2000 WL 1375274 (D. Kan. 2000); *League of Minn. Cities Ins. Trust v. City of Coon Rapids*, 446 N.W.2d 419 (Minn. 1989) (injuries caused by high nitrogen dioxide levels in an arena arising from by-products from a Zamboni machine are excluded); *Park Ohio Indus. v. Home Indem. Co.*, 785 F. Supp. 670 (N.D. Ohio 1991); *aff'd,* 975 F.2d 1215 (6th Cir. 1992) (injury caused by particulates arising from a rubber denuding process excluded).

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Coverage also has been found in cases involving carbon monoxide emitted from residential heaters.[141] Similarly, in a case that may have ramifications for "sick building" claims, the Alabama Supreme Court held that the absolute pollution exclusion did not apply where workers dismantling a building were exposed to asbestos because the asbestos was not released in the "atmosphere" within the meaning of the exclusion.[142] And the absolute pollution exclusion has been held inapplicable to personal injury allegedly caused by children ingesting lead-containing paint.[143]

Another context in which the absolute pollution exclusion may not bar coverage is where there are multiple causes of the damage, one of which was not the alleged polluting activity. In such a context, one court has found coverage where the injured party was not "claiming its facilities were polluted or contaminated but rather that they were destroyed or damaged by an explosion and fire."[144]

§5.4 Requirement of Occurrence and Trigger of Coverage

The term "occurrence" often is defined in the policy. Where the policy contains a definition of the term, the definition governs. A typical definition in policies issued after 1966 provides that "[a]n occurrence means an accident including a continuous or repeated exposure to

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141 *Regional Bank of Colo. v. St. Paul Fire & Marine Ins. Co.*, 35 F.3d 494, 498 (10th Cir. 1994). *See also Stoney Run Co. v. Prudential-LMI Commercial Ins. Co.*, 47 F.3d 34 (2d Cir. 1995) (carbon monoxide released from furnace not a pollutant); *American States Insurance Co. v. Koloms*, 666 N.E.2d 699 (Ill. App. Ct. 1996) (same); *Motorists Mutual Ins. Co. v. RSJ Inc.*, 926 S.W.2d 679 (Ky. App. 1996) (carbon dioxide leaking from vent pipe not within pollution exclusion); *Calvert Ins. Co. v. S & L Realty Corp.*, 926 F. Supp. 44 (S.D. N.Y. 1996) (glue and cement not pollutants). *But see Assicurazioni Generali v. Neil*, 160 F.3d 997 (4th Cir. 1998) (pollution exclusion bars coverage for carbon monoxide poisoning); *Bernhardt v. Hartford Fire Ins. Co.*, 102 Md. App. 45, 648 A.2d 1047 (1994) (carbon monoxide a gaseous irritant or contaminant); *Millers Mutual Ins. Assoc. of Illinois v. Graham Oil Co.*, 668 N.E.2d 223 (Ill. App. Ct. 1996) (gasoline can be a contaminant).

142 *Essex Ins. Co. v. Avondale Mills, Inc.*, 639 So.2d 1339, 1341 (Ala. 1994); *see also Donaldson v. Urban Land Interests*, Inc. 564 N.W.2d 728 (Ala. 1997) (inadequately ventilated carbon dioxide from human respiration was not "pollutant" within meaning of ambiguous "absolute" pollution exclusion); *Brian Chuchua's Jeep, Inc. v. Farmer's Ins Co.*, 10 Cal. App. 4th 1579, 13 Cal. Rptr. 2d 444 (1992) (a policy including earthquake coverage but containing an "absolute" pollution exclusion covers the cost of cleaning up contaminants released from a facility damaged during an earthquake, because the earthquake was the efficient proximate cause of the loss).

143 *Ins. Co. of Illinois v. Katalina Stringfield*, 292 Ill. App. 3d 471, 685 N.E.2d 980 (1997).

144 *Pepper Indus. v. Home Ins. Co.*, 67 Cal. App. 3d 1012, 1019, 134 Cal. Rptr. 904, 908 (1977). *But see American States Ins. Co. v. Skrobis Painting & Decorating, Inc.*, 182 Wis.2d 445, 454, 513 N.W. 2d 695, 698-99 (1994) (release of fuel during storm not covered occurrence), *rev. denied*, 520 N.W.2d 88 (Wis. 1994).

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conditions which results, during the policy period, in bodily injury or property damage neither expected nor intended from the standpoint of the insured." The adoption of "occurrence" language to replace the "accident" language appearing in many earlier policies was intended to permit coverage for injury resulting from gradual or ongoing events, since an "occurrence" included a "continuous or repeated exposure to conditions."

A definition of "occurrence" sometimes found in policies requires that property damage occur during the policy period regardless of whether the acts or a series of acts giving rise to the damage took place within the policy period. Where so defined, property damage during the policy period is required.[145] Absent a definition of occurrence in the policy, the policy provides coverage where the act or damage or both occur during the policy period.[146]

In a non-environmental case, injury typically occurs at a single moment (*e.g.*, a defective widget causes injury). In these sorts of cases, most courts hold that it is the date of injury, not the date of negligent manufacture of the widget, which triggers coverage.[147] They do so based upon the rationale that CGL policies typically only cover injury, and injury consequently must take place before the coverage is implicated.[148]

Where policy language requires injury during the policy period, and where chemical release and resulting injury have continued during multiple years, courts have developed four different approaches to determining which policies provide coverage. These approaches, or policy "triggers," are defined in cases. They are called "exposure," "manifestation," "continuous" and "injury" or "injury-in-fact" triggers. Case law is sharply divided throughout the country as to which theory of trigger of coverage is appropriate, particularly for environmental claims.

Under an exposure trigger, all policies in effect during the period of exposure to the harmful substance are triggered.[149] The rationale of these cases does not turn on the policy

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145 *Remmer v. Glens Falls Indem. Co.*, 140 Cal. App. 2d 84, 88, 295 P.2d 19, 21 (1956); *Blue Streak Indus. v. N.L. Indus. Inc.*, 650 F. Supp. 733, 736 (E.D. La. 1986); *Prieto v. Reserve Ins. Co.*, 340 So.2d 1282, 1283 (Fla. Dist. Ct. App. 1977); *Millers Mut. Fire Ins. Co. v. Ed Bailey, Inc.*, 103 Idaho 377, 647 P.2d 1249 (1982); *Stillwell v. Brock Bros. Inc.*, 736 F. Supp. 201, 205 (S.D. Ind. 1990) (applying Kentucky law).

146 *Insurance Co. of N. Am. v. Sam Harris Constr. Co.*, 22 Cal. 3d 409, 412-13, 583 P.2d 1335, 1336, 149 Cal. Rptr. 292 (1978).

147 *See, e.g.*, *Wolf Mach. Co. v. Insurance Co. of N. Am.*, 133 Cal. App. 3d 324, 328, 183 Cal. Rptr. 695, 697 (1982).

148 *See, e.g.*, *Smith v. Hughes Aircraft Co.*, 22 F.3d 1432, 1440-41 (9th Cir. 1993); *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 61-62 (3d Cir. 1982) (declining to make choice of law between Pennsylvania and Michigan).

149 *See, e.g.*, *Hancock Lab., Inc. v. Admiral Ins. Co.*, 777 F.2d 520, 523 (9th Cir. 1985) (applying California law); *Insurance Co. of N. Am. v. Forty-Eight Insulations*, 633 F.2d 1212 (6th Cir. 1980) (applying Illinois and New Jersey law), *aff'd. and clarified on rehearing*, 657 F.2d 814 (6th Cir.), *cert. denied*, 454 U.S. 1109 (1981). *See also Oxner v.*

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language, but instead focuses upon ease of applying the theory to bodily injury or property damage liability by simply determining when the claimant, or the claimant's property, was exposed to the harmful agent.

Under a manifestation trigger, only those policies in effect when the alleged injurious condition "manifests" itself (is first discovered) provide coverage. In California, this is the rule for first party insurance cases which require notice within 12 months after "inception of loss."[150] Some jurisdictions, but not California, have adopted the "manifestation" trigger for third party liability claims.[151]

Under a continuous trigger, all policies in effect are triggered from the date of first exposure to the harmful substance through and including the date of manifestation of injury. This theory of coverage grew out of the decision of the D.C. Circuit in *Keene Corp. v. Insurance Co. of N. Am.*[152] Courts adopting the "continuous trigger" theory of coverage typically reject "manifestation" trigger authority as unsupported by any policy language and contrary to the notion that insurance shifts risk to the insurer.[153] In addition, some courts adopting the continuous trigger theory have reasoned that the manifestation trigger, by focusing on discovery, effectively transmutes "occurrence" policies into "claims made" policies by focusing coverage for progressive injuries in a single policy rather than extending it through multiple policy terms. In California, the Supreme Court recently adopted this theory of coverage for third party liability policies in *Montrose Chem. Corp. v. Admiral Ins. Co.*[154] Where a continuing trigger has been adopted, some courts hold that once a policy has been "triggered," it must pay damages to the extent of the policy limits, regardless of whether damage continues after the termination of the

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Montgomery, 794 So. 2d 86 (La. Ct. App. 2d Cir. 2001); *Pilgrim Enterprises, Inc. v. Maryland Casualty Co*., 24 S.W.3d 488 (Tex. App. 2000).

150 *Prudential-LMI Commercial Ins. Co. v. Superior Court*, 51 Cal. 3d 674, 687, 798 P.2d 1230, 1238-39, 274 Cal. Rptr. 387 (1990) (quoting *Williams Studio of Photography v. Nationwide Mut. Fire Ins. Co.*, 380 Pa. Super 1, 550 A.2d 1333, 1335 (1988).)

151 *See, e.g., Eagle-Pitcher Indus., Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 12, 23-24 (1st Cir. 1982), *cert. denied*, 460 U.S. 1028, 103 S.Ct. 1280 (1983) (applying Illinois and Ohio law); *Mraz v. Canadian Universal Ins. Co.*, 804 F.2d 1325, 1328 (4th Cir. 1986) (interpreting Maryland law). However, the Maryland Court of Appeals rejected *Mraz* in *Hartford County v. Hartford Mut. Ins. Co.*, 327 Md. 418, 431, 610 A.2d 286, 292 (1992). *See also CPC International Inc. v. Northbrook Excess & Surplus Ins. Co.*, 673 A.2d 71 (R.I. 1995) (applying Rhode Island law); *Lafayette Ins. Co. v. C.E. Albert Construction Co.*, 661 So.2d 1093 (La. Ct. App. 1995), *cert. denied*, 666 So.2d 296 (La. 1996) (applying Louisiana law).

152 667 F.2d 1034, 1047 (D.C. Cir. 1981), *cert. denied*, 445 U.S. 1007 (1982).

153 *E.g.*, *Bristol-Myers Squibb Co. v. AIU Insur. Co.*, No. A-0145672, 1995 WL 861100 (Tex. Dist. Ct. Jefferson Co. May 3, 1996).

154 10 Cal. 4th 645, 655, 913 P.2d 878, 42 Cal. Rptr. 2d 324 (1995).

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policy period.[155] Other courts have held that notwithstanding the absence of any pertinent contract language, the policyholder nevertheless may be responsible for damages during periods when the policyholder had no insurance.[156]

Under an injury or injury-in-fact trigger, policies in effect when injury occurs provide coverage. Where an "injury" test is applied and the injury is continuous and progressive during multiple policy periods, policies in effect during those policy periods are triggered.[157] Applying this principle in an environmental context, the first policy triggered would be that in effect when chemicals first entered the groundwater in concentrations sufficiently large to be deemed to have caused damage; later policies would be triggered where additional chemicals seeped into the groundwater. Some jurisdictions, however, have interpreted the "injury in fact" trigger differently. In *Maryland Casualty Co. v. W.R. Grace & Co.*,[158] the Second Circuit applied the "injury in fact" trigger to cases involving property damage. The court concluded that under New York law "incorporation of a defective product into another product inflicts property damage."[159] In *Independent Petrochemical Corp. v. Aetna Casualty & Sur. Co.*,[160] the court determined that the injury triggering a policy can only happen at one particular point in time, regardless of the extent of the exposure to the injuring agent.

In some policies, the monetary limits are expressed on a "per occurrence" basis. This represents the amount of coverage provided for each occurrence. In many jurisdictions, the

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155 *Id.* at 680, 689; *Armstrong World Industries v. Aetna Cas. & Sur. Co.,* 45 Cal. App. 4th 1, 55-57 (1996). *See also Public Service Co. of Colorado v. Wallis and Companies*, 986 P.2d 924 (Colo. 1999).

156 *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740 (Ill. App. 1996).

157 *Gaston County Dyeing Mach. Co. v. Northfield Ins. Co.*, 351 N.C. 293, 524 S.E.2d 558 (2000); *Spartan Petroleum Co., Inc. v. Federated Mut. Ins. Co*., 162 F.3d 805 (4th Cir. 1998); *Gelman Sciences, Inc. v. Fidelity & Casualty Co.,* 465 Mich. 305, 572 N.W.2d 617 (Mich. 1998); *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 476, 193 Cal. Rptr. 461 (1983); *Stonewall Ins. Co. v. Asbestos Claims Management Corp.*, 73 F.3d 1178 (2d Cir. 1995) (applying New York and Texas law), *modified*, 85 F.3d 49 (2d Cir. 1996). "Conceptually, the injury-in-fact trigger and the continuous trigger are on the same continuum and are complementary, rather than mutually exclusive. Accordingly, courts have stated that 'where injury-in-fact occurs continuously over a period covered by different insurers or policies, and actual apportionment of the injury is difficult or impossible to determine, the continuous injury trigger may be employed to equitably apportion liability among insurers.'" *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 670 N.E.2d 740, 748 (Ill. App. 1996) (quoting *U.S. Gypsum Co. v. Admiral Ins. Co.*, 643 N.E. 2d 1226 (Ill. App. 1994).)

158 23 F.3d 617 (2d Cir. 1994) (applying New York law).

159 23 F.3d, 617, 624 (2d Cir. 1994).

160 654 F. Supp. 1334, 1358 (D. D.C. 1986) (applying Missouri and New York law), *aff'd. in part, rev.'d in part on other grounds,* 944 F. 2d 940 (D.C. Cir. 1991), *cert. denied,* 503 U.S. 1011 (1992).

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number of occurrences is determined by the number of causes of injury, not the number of injuries.[161] In determining relevant "cause," some courts have focused on the circumstances associated with a specific discharge; others take a broader approach, linking numerous discrete causes under a broader ambit of a corporate policy.[162] In contrast, some jurisdictions determine the number of occurrences based upon the number of injuries.[163] A third approach is to treat each separate incident of liability, rather than the number of injuries or the number of causes, as giving rise to the occurrence.[164]

Some policies contain an "aggregate limits" provision, which states the maximum liability of the insurance company for indemnity regardless of the number or value of the claims.[165] Depending upon the age of the policy, the aggregate limits provision may not apply to "bodily injury" at all and may apply only to certain types of "property damage." Most significantly, the limit may not apply to property damage happening away from the insured's principal place of business. Careful consideration should be given to the precise terms of the "aggregate limits" provisions under policies potentially triggered by an environmental claim.

§5.5 Notice of Claim

Policies commonly require the policyholder to provide prompt notice of claims or potential claims. In many jurisdictions, failure to do so can defeat coverage only if the insurance company is substantially prejudiced by the delay,[166] or if the delay is unreasonable under the

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161 *United Services Auto. Ass'n v. Baggett*, 209 Cal. App. 3d 1387, 1393, 258 Cal. Rptr. 52, 56 (1989).

162 *See, e.g. Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 59 (3d Cir. 1982); *Aguirre v. City of N.Y.*, 214 A.D. 2d 692, 625 N.Y.S.2d 597, 598 (1995).

163 *See, e.g. Slater v. United States Fidelity & Guar. Co.*, 379 Mass. 801, 400 N.E.2d 1256, 1261-62 (1980).

164 *See, e.g. Maurice Pincoffs Co. v. St. Paul Fire & Marine Ins. Co.*, 447 F.2d 204, 206 (5th Cir. 1971) (applying Texas law).

165 *Gilliam v. American Casualty Co.*, 735 F. Supp. 345, 350 (N.D. Cal. 1990).

166 *Hyde Athletics Inds., Inc. v. Continental Cas. Co.*, 969 F. Supp. 289 (E.D. Pa. 1997) (under Pennsylvania law, insurer must prove that notice was untimely and that delay caused prejudice); *Fed. Ins. Co. v. Purex Inds. Inc.*, 972 F. Supp. 872 (D.N.J. 1997) (New Jersey law is clear that insurer must prove breach of the notice provision and appreciable prejudice); *Olds-Olympic, Inc. v. Commercial Union Ins. Co.*, 918 P.2d 923, 931 fn. 21 (Wash. 1996); *Johnson Controls, Inc. v. Bownes*, 409 N.E.2d 185, 188 (Mass. 1980); *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 760-62, 15 Cal. Rptr. 2d 815 (1993); *Lusch v. Aetna Cas. & Surety Co.*, 272 Or. 593, 597-600, 538 P.2d 902 (1975). In both California and Oregon, the burden is on the insurance company to establish the prejudice. *Halsey v. Fireman's Fund Ins. Co.*, 68 Or. App. 349, 354, 681 P.2d 168 (1984). Other jurisdictions may presume prejudice. (*See* discussion in section 4.11 above.) *But see Town of Mt. Pleasant v. Hartford Acc. & Indem. Co.*, 241 Wis.2d 327, 2001 WI App. 38, 625 N.W.2d 317 (Wis. App. 2001) (finding notice was late and

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circumstances.[167] In a first party context, notice commonly must be provided within one year of "inception of loss" which is "that point in time when appreciable damage occurs and is or should be known to the insured such that a reasonable insured would be aware that his notification duty under the policy has been triggered."[168]

§5.6 Duty to Cooperate

In first party policies, the policyholder has an obligation to cooperate with its insurance company and provide information that it seeks.[169]

In third party policies, the duty to cooperate arises only where the insurance company has accepted the policyholder's defense. It arises from a "cooperation" clause by which the policyholder agrees to cooperate with the insurance company in the insurance company's defense of third party litigation. A policyholder's breach of the provision, absent an insurance company's waiver or estoppel, can be a defense to liability on the policy.[170] However,

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prejudicial as a matter of law); *South Carolina Ins. Co. v. Coody*, 957 F. Supp. 234 (M.D. Ga. 1997) (under Georgia law, duty to provide notice to liability insurer is triggered when insured actually knew or should have known of possibility that it might be held liable for occurrence in question and compliance with notice provision acts as a condition precedent for coverage under the policy); *Champion Spark Plug Co. v. Fidelity & Casualty Co. of New York*, 687 N.E.2d 785 (Ohio App. 1996) (summary judgment granted insurers where policyholder did not prove that insurers could discover same information learned with timely notice).

167 *See, e.g., Dico, Inc. v. Employers Ins. Of Wausau,* 581 N.W. 2d 607 (Iowa 1998); *Alabama Plating Co. v. U.S. Fid. & Guar. Co.*, 690 So.2d 331 (Ala. 1996).

168 *Prudential-LMI Commercial Ins. v. Superior Court*, 51 Cal. 3d 674, 678, 798 P.2d 1230, 1232 (1990). However, some jurisdictions hold that the notice under property policies must be given within the specified time period after the loss begins regardless of the date of discovery of the loss. *See Wabash Power Equip. Co. v. International Ins. Co.*, 184 Ill. App. 3d 838, 843-45, 540 N.E.2d 960, 964-65 (1989).

169 *See, e.g., Weissberg v. Royal Ins. Co*., 240 A.D.2d 733, 659 N.Y.S.2d 505 (2d Dep't 1997); *Pilgrim v. State Farm Fire & Cas. Ins. Co*., 89 Wash. App. 712, 950 P.2d 479 (Div. 1 1997); *Crowell v. State Farm Fire & Casualty Co.*, 259 Ill. App. 3d 456, 459-60, 631 N.E.2d 418, 420 (1994).

170 *State Farm Fire & Cas. Co. v. Miller*, 5 Cal. App. 3d 837, 840, 85 Cal. Rptr. 288 (1970). Examples of breach include: *Wildrick v. North River Ins. Co*., 75 F.3d 432 (8th Cir. 1996) (persistent lying); *Hynding v. Home Accident Ins. Co.*, 214 Cal. 743, 752, 7 P.2d 999 (1932) (failure to attend trial); *Lebron v. Allstate Ins. Co.*, 179 A.D.2d 623, 578 N.Y.S.2d 239 (1992) (failure to provide tax returns); *Nationwide Mut. Ins. Co. v. Graham*, 275 A.D.2d 1012, 713 N.Y.S.2d 602 (4th Dep't 2000) (false report of accident). *See also Paint Shuttle, Inc. v. Continental Cas. Co*., 733 N.E.2d 513 (Ind. Ct. App. 2000) (discussing the interests of the insurer in investigating and preparing an adequate defense as underlying both the notice provision and cooperation clause of an insurance policy).

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an insurer must show that it took sufficient steps to obtain the insured's participation in the suit, before it will be relieved of its duty to defend and indemnify.[171]

In most jurisdictions, the insurance company has the burden of proving that it was "substantially prejudiced by the failure of the insured to cooperate."[172] But some jurisdictions hold that prejudice is not necessary or is presumed.[173] Still others impose upon the insured the burden of proving substantial compliance with the duty to cooperate.[174]

§5.7 Multiple Causes of Losses, Some Covered, Some Not

Some jurisdictions distinguish between the first party context where a covered event must be the "efficient proximate cause of the loss" for the policy to apply and the third party context where a loss is covered if any one of the multiple causes of that loss is covered.[175]

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171 *Wallace v. Woolfolk*, 312 Ill. App. 3d 1178, 1183, 728 N.E.2d 816, 820 (5th Dist. 2000) (where insured failed to attend deposition and mandatory arbitration, mailing of six letters via regular mail without any acknowledgment by insured did not satisfy insurer's duty to seek insured's cooperation).

172 *See, e.g.*, *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 587 P.2d 1098, 151 Cal. Rptr. 285 (1978); *Fine v. Bellefonte Underwriters Inc. Co.*, 725 F.2d 179 (2d. Cir. 1984) (applying New York law); *Lumpkins v. Grange Mut. Companies*, 553 N.E.2d 871, 874 (Ind. Ct. App. 1990); *Chemical Leaman Tank Lines, Inc. v. Aetna Casualty & Sur. Co.*, 817 F. Supp. 1136, 1158 (D.N.J. 1993), *aff'd*, 89 F.3d 976 (3d Cir. 1996) (applying New Jersey law); *Weller v. Farris*, 125 Ohio App. 3d 270, 708 N.E.2d 271 (2d Dist. Montgomery County 1998); *Cooper v. Governmental Employees Ins. Co.*, 51 N.J. 86, 94, 237 A.2d 870 (1968); *Sherwin-Williams v. Certain Underwriters at Lloyds London*, 813 F. Supp. 576, 588 (N.D. Ohio 1993) (applying Ohio law); *New Coleman Holdings Inc. v. Aetna Casualty & Surety Co.,* 1995 WL 708684 (D. Kan. 1995); *Dietz v. Hardware Dealers Mut. Fire Ins. Co.*, 88 Wis.2d 496, 276 N.W.2d 808, 812 (1979).

173 *See, e.g.*, *Allstate Indem. Co. v. Fifer*, 47 F. Supp. 2d 913 (W.D. Tenn. 1998)**;** *Simpson v. U.S. Fidelity & Guar. Co*., 562 N.W.2d 627, 631-32 (Iowa 1997); *Insurance Co. of N. Amer. v. City of Chicago*, 62 Ill. App. 3d 80, 83, 379 N.E.2d 34 (1978); *Chrysler First Fin. Serv. Corp. of Am. v. Chicago Title Ins. Co.*, 156 Misc. 2d 814, 595 N.Y.S.2d 302 (Sup. Ct. 1993).

174 *See, e.g., Ogunsuada v. General Acc. Ins. Co. of America*, 695 A.2d 996, 999 (R.I. 1997).

175 *State Farm Mut. Auto. Ins. Co. v. Partridge*, 10 Cal. 3d 94, 514 P.2d 123, 109 Cal. Rptr. 811 (1973); *Garvey v. State Farm Fire & Casualty Co.*, 48 Cal. 3d 395, 408-09, 770 P.2d 704, 257 Cal. Rptr. 292 (1989). Other jurisdictions that have adopted the "concurrent causation" rationale to extend coverage include *Waseca Mut. Ins. Co. v. Noska*, 331 N.W.2d 917, 921 (Minn. 1983); *United States Fidelity & Guar. Co. v. State Farm Mut. Auto. Ins. Co.,* 107 Ill.App.3d 190, 192-93, 437 N.E.2d 663 (1982); *Lawyer v. Boling*, 71 Wis.2d 408, 238 N.W.2d 514, 521-22 (1976); *Cantrell v. Farm Bureau Town & County, Ins. Co. of Missouri*, 876 S.W.2d 660, 663 (Mo. Ct. App. 1994); *Allstate Ins. Co. v. Watts*, 811 S.W.2d 883, 887-88 (Tenn. 1991). Some other jurisdictions, however, have rejected this rationale for third-party liability policies. *See, e.g. Vanguard Ins. Co. v.*

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Other jurisdictions use the "efficient proximate cause" as a determinant of coverage.[176] It seems to be clear that if a covered loss sets into play a series of events that include uncovered happenings, coverage still applies.[177]

6. RULES OF POLICY CONSTRUCTION

§6.1 Plain Meaning and the Policyholder's Reasonable Expectations

As a general rule, language of an insurance policy will be given its plain, ordinary and popular meaning rather than a strict legal or technical meaning. The policy should be read as a layperson would read it, not as it might be analyzed by an attorney or an insurance expert.[178] These general principles govern unless the terms were used in a technical sense, or they have received a special meaning by usage.[179]

Most jurisdictions construe insurance policies according to the policyholder's "reasonable expectations."[180] As Professor Keeton wrote, "this principle incorporates the

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Clarke, 438 Mich. 463, 474-75, 475 N.W.2d 48, 53 (1991). *Northern Assurance Co. of America v. EOP Floors, Inc.*, 311 Md. 217, 533 A.2d 682 (1987) (concurrent causation irrelevant if loss also arises from excluded event). At least one court has applied a "divisible causation" test, finding no coverage unless the covered cause could have operated independently of the non-covered cause to bring about the loss. *Austin Mutual Ins. Co. v. Klande*, 563 N.W.2d 282 (Minn. App. 1997).

176 *See, e.g. Frontis v. Milwaukee Ins. Co.*, 156 Conn. 492, 242 A.2d 749 (1968).

177 *See, e.g., Franklin Packaging Co. v. California Union Ins. Co.*, 171 N.J. Super. 188, 191, 408 A.2d 448, 449 (App. Div. 1979), *cert. denied*, 420 A.2d 340 (N.J. 1980) (holding that policy applicable to vandalism covered a loss that occurred when vandals drove a truck into an air conditioner and caused blockage of a drain resulting in water backup and damage to the insured's inventory despite an exclusion in the policy for loss from water backing up through sewers or drains).

178 *Safeco Ins. Co. of America v. Robert S.*, 26 Cal. 4th 758, 765- 766, 110 Cal. Rptr. 2d 844, 850 (2001).

179 *Farmlands Inds., Inc. v. Republic Ins. Co.*, 941 S.W.2d 505 (1997); *New Castle County v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1183 (3rd Cir. 1991); *Western World Ins. Co. v. Stack Oil, Inc.*, 922 F.2d 118, 121 (2nd Cir. 1990); *DeForte v. Allstate Ins. Co.*, 81 A.D.2d 465, 442 N.Y.S.2d 307, 310 (1981); *Aerojet-General Corp. v. Superior Court*, 211 Cal. App. 3d 216, 224, 258 Cal. Rptr. 684 (1988); *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 822, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990).

180 *See, e.g., Andersen v. Highland House Co*., 93 Ohio St. 3d 547, 757 N.E.2d 329 (2001); *Garden State Indem. Co. v. Miller & Pincus*, 340 N.J. Super. 148, 773 A.2d 1204 (App. Div. 2001); *Miller v. Title Ins. Co. of Minnesota*, 1999 MT 230, 987 P.2d 1151 (Mont. 1999); *Consolidation Coal Co. v. Boston Old Colony Ins. Co*., 508 S.E.2d 102 (W. Va. 1998); *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 822, 799 P.2d 1253, 1264, 274 Cal. Rptr. 820 (1990); *Mason v. State Farm Mut. Auto Ins. Co.*, 148 Ariz. 271, 714 P.2d 441 (Ct. App. 1985).

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proposition that policy language will be construed as laymen would understand it and not according to the interpretation of sophisticated underwriters."[181] Whether the policyholder's expectation of coverage is reasonable is a question of law,[182] determined on an "objective" basis.[183]

To protect the policyholder's reasonable expectation of coverage, the insurance policy will be given such interpretation as is "semantically permissible" to "fairly achieve its object of providing indemnity for the loss to which the insurance relates."[184] As one court has stated, "[C]overage clauses are interpreted broadly so as to afford the greatest possible protection to the insured; exclusionary clauses are interpreted narrowly against the insurer" (citations omitted).[185] Still, some jurisdictions hold that a conspicuous, plain and clear manifestation of the insurance company's intent to exclude coverage will defeat the insured's reasonable expectation.[186]

Other jurisdictions have rejected the reasonable expectations doctrine. They reason that this doctrine conflicts with the general rule of contract interpretation that unambiguous contract terms must be given effect.[187]

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181 Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 Harv. L. Rev. 961, 967 (1970).

182 *Hallmark Ins. Co. v. Superior Court*, 201 Cal. App. 3d 1014, 1019, 247 Cal. Rptr. 638 (1988).

183 *Westfield Ins. Companies v. Economy Fire & Cas. Co*., 623 N.W.2d 871 (Iowa 2001); *Averett v. Farmers Ins. Co.*, 177 Ariz. 531, 869 P.2d 505, 506 (1994).

184 *Harris v. Glens Falls Ins. Co.*, 6 Cal. 3d 699, 493 P.2d 861, 100 Cal. Rptr. 133 (1972).

185 *Reserve Ins. Co. v. Pisciotta*, 30 Cal. 3d 800, 808, 640 P.2d 764 (1982); *Deni Associates of Florida Inc. v. State Farm Fire & Cas. Ins. Co*., 711 So. 2d 1135 (Fla. 1998); *West Am. Ins. v. Tufco Flooring*, 104 N.C. App. 312, 409 S.E.2d 692, 697 (1991).

186 *Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd. v. Federated Mut. Ins. Co*., 596 N.W.2d 546 (Iowa 1999); *Philadelphia Indemnity Ins. Co. v. Morris*, 990 S.W.2d 621 (Ky. 1999).

187 *See, e.g.*, *Northbrook Excess & Surplus Ins. Co. v. Proctor & Gamble Co.*, 924 F.2d 633, 639 n.8 (7th Cir. 1991) (applying Ohio law); *American Country Ins. Co. v. Cash*, 171 Ill. App. 3d 9, 11, 524 N.E.2d 1016, 1018 (1988). *See also Resure, Inc. v. Chemical Distributors, Inc.*, 927 F. Supp. 190 (M.D. La. 1996) *aff'd* 114 F.3d 1184 (5th Cir. 1987) (doctrine inapplicable to businesses or to sophisticated businesspersons under New Mexico law), *cert. denied*, 118 S.Ct. 1511 (1998). *But see Stone Container Corp. v. Hartford Steam Boiler Inspection Co.*, 936 F. Supp. 487 (N.D. Ill. 1996) (exclusions must be read in conjunction with reasonable expectations of the insured).

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§6.2 Determination of Whether Ambiguities Exist

An insurance policy term is ambiguous if it is susceptible to more than one reasonable meaning.[188] Whether there is an ambiguity in policy language is to determined from the perspective of the layperson.[189]

Whether there is an ambiguity in policy language is to determined from the perspective of the layperson.[190] While not determinative of ambiguity, dictionaries may assist the court in determining whether wording reasonably is subject to the interpretation urged by the policyholder. Courts also may refer to decisions from other jurisdictions, the reasoning being that judges are reasonable and if another judge has accepted a policyholders' construction of a given term, the construction must be reasonable.[191]

Courts also may consider extrinsic evidence.[192] As Chief Justice Traynor of the California Supreme Court explained in *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*,: "A rule that would limit the determination of the meaning of a written instrument to its four corners merely because it seems to the court to be clear and unambiguous, would either deny the relevance of the intention of the parties, or presuppose a degree of verbal precision and stability our language has not attained."[193]

One type of extrinsic evidence that is often considered is the drafting, regulatory and marketing history of standard form CGL provisions.[194] In addition to demonstrating what the language was intended to mean, this evidence also can establish that the language reasonably

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188 *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

189 *Garza v. Marine Transport Lines, Inc.,* 861 F.2d 23, 27 (2d Cir. 1988); *Farm Bureau Mut. Ins. Co. v. Laudick*, 18 Kan. App. 2d 782, 784, 859 P.2d 410, 412 (1993); *Spaid v. Cal-Western States Life Ins. Co.*, 130 Cal. App. 3d 803, 806, 182 Cal. Rptr. 3 (1982).

190 *Reserve Ins. Co. v. Pisciotta*, 30 Cal. 3d 800, 810, 640 P.2d 764, 769, 180 Cal. Rptr. 628 (1982). *See also, Abrams v. State Farm Fire & Cas. Co.,* 306 Ill. App. 3d 545, 239 Ill. Dec. 534, 714 N.E.2d 92 (1st Dist. 1999); *Alabama Plating Co. v. U.S. Fid. & Guar. Co.*, 690 So.2d 331 (Ala. 1996). *But see Iowa Comprehensive Petroleum Underground Storage Tank Board v. Farmland Mut. Ins. Co.*, 568 N.W.2d 815 (Iowa 1997) ("[T]he existence of more than one dictionary definition not the *sine qua non* of ambiguity. If it were, few words would be unambiguous" [quoting *New Castle County v. Hartford Acc. & Indem. Co.*, 933 F.2d 1162, 1193(3rd Cir. 1991)]).

191 *See, e.g.*, *Minnesota Mining & Mfg. Co. v. Travelers Indem. Co.*, 457 N.W.2d 175, 180 (Minn. 1990).

192 *Hanneman v. Continental Western Ins. Co*., 1998 ND 46, 575 N.W.2d 445 (N.D. 1998).

193 *Pacific Gas & Elec. Co. v. G.H. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 37, 442 P.2d 641, 694, 69 Cal. Rptr. 561, 564 (1968).

194 *See, e.g.*, *Montrose Chemical Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 669, 913 P.2d 878, 42 Cal. Rptr. 2d 324 (1995) (on trigger of coverage), *as modified on denial of rehearing* (Cal. Aug. 31, 1995).

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is susceptible to an interpretation urged by the policyholder, and therefore should be binding on the insurance company.[195] As one court has observed, these materials are "of considerable assistance in determining precisely what risks the ... policies cover."[196] If the extrinsic evidence raises credibility issues concerning the intent of the parties, and the interpretation of a policy provision depends upon a choice among reasonable inferences to be drawn from the extrinsic evidence, the meaning of the ambiguous policy term should be presented to a trier of fact.[197]

§6.3 Contra Proferentem

Generally, in contract law, ambiguities are construed against the drafter of the language.[198] This rule applies with equal force to insurance policies.[199] As the Arizona Supreme Court explained in *Darner Motor Sales v. Universal Underwriters Ins. Co.*,[200]:

> [T]he usual insurance policy is a special kind of contract. It is largely adhesive; some terms are bargained for, but most terms consist of boilerplate, not bargained for, neither read nor understood by the buyer, and often not even fully understood by the selling agent. In contracts, as in other fields, the common law has evolved to accommodate the practices of the marketplace.

Recognizing that these practices preclude arms length negotiation, *Darner* adopted *Restatement (Second) of Contracts*, § 211(2) which provides that "such a writing is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the agreement."

For these reasons, if an ambiguity relates to the extent of coverage, the policy language will be understood in its most inclusive sense, for the benefit of the insured.[201] As one

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195 *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990); *see also Tymshare, Inc. v. Covell*, 727 F.2d 1145, 1150 (D.C. Cir. 1984).

196 *Maryland Casualty Co. v. Reeder*, 221 Cal. App. 3d 961, 968, 971-72, 270 Cal. Rptr. 719, 722 (1990).

197 *Northbrook Excess and Surplus Ins. Co. v. Proctor & Gamble Co.*, 924 F.2d 633, 637 (7th Cir. 1991); *Taylor v. State Farm Mut. Auto. Ins. Co.*, 175 Ariz. 148, 152, 854 P.2d 1134, 1138 (1993).

198 *See Restatement (Second) of Contracts* § 206 (1981).

199 *Donaldson v. Urban Land Interests, Inc.*, 564 N.W.2d 728 (1997) (Wisconsin Supreme Court applying *contra preferentem* in construing ambiguous "absolute" pollution exclusion); *Westchester Resco Co. v. New England Reinsurance Corp.*, 818 F.2d 2, 3 (2d Cir. 1987); *New Castle County v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1182 (3rd Cir. 1991) (on pollution exclusion); *Allstate Ins. Co. v. Dana Corp*., 737 N.E.2d 1177 (Ind. Ct. App. 2000); *Abrams v. State Farm Fire & Cas. Co*., 306 Ill. App. 3d 545, 714 N.E.2d 92 (1999).

200 *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 390, 682 P.2d 388, 395 (1984).

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court has explained, "The policy, although of the standard form, was prepared by insurers, who are presumed to have had their own interests primarily in view; and hence, when the meaning is doubtful, it should be construed most favorably to the insured, who had nothing to do with the preparation thereof."[202]

Often policy wordings are created not by a specific insurance company but instead by an insurance industry organization now called the Insurance Services Office ("ISO"), previously known as the Insurance Rating Board ("IRB"), the Mutual Insurance Rating Bureau ("MIRB") or the National Bureau of Casualty Underwriters ("NBCU"). These entities have drafted standard form policy language since the early 1940s.[203] Even though this wording technically may not have been crafted by the insurance company itself, courts routinely hold that any ambiguity in this standard form language still will be construed against the insurance company.[204]

Where relevant wording is not form wording, and where there is evidence that the policyholder participated in creation of the wording is disputed, rules of *contra proferentem* may be inapplicable.[205] Some jurisdictions have declined to apply contra proferentem against the insurance company where various factors were present which may have reduced the magnitude of the unequal bargaining position, such as the size of the policyholder, involvement of counsel or broker in negotiations, or the insurance sophistication of the policyholder.[206]

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201 *Liverpool & London Globe Ins. Co. v. Kearney*, 180 U.S. 132, 135-36, 21 S.Ct. 326, 327-28, 45 L.Ed. 460 (1901).

202 *Matthews v. American Cent. Ins. Co.*, 154 N.Y. 449, 456-57, 48 N.E. 751, 752 (1897) *See also Reserve Ins. Co. v. Pisciotta*, 30 Cal. 3d 800, 808, 640 P.2d 764, 768, 180 Cal. Rptr. 628 (1982); *West American Ins. v. Tufco Flooring East*, *Inc.*, 104 N.C. App. 312, 320, 409 S.E.2d 692, 697 (1991).

203 *See In re Ins. Antitrust Litig.*, 723 F. Supp. 464, 468 (N.D. Cal. 1989), *rev'd*, 938 F.2d 914 (9th Cir. 1991), *aff'd in part, rev'd in part sub nom*, *Hartford Fire Ins. Co. v. California*, 113 S.Ct. 2891, 125 L. Ed. 2d 612 (1993).

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

205 *See generally, Garcia v. Truck Ins. Exch.*, 36 Cal. 3d 426, 438, n.6, 682 P.2d 1100, 1106, 204 Cal. Rptr. 435 (1984).

206 *See, e.g., First State Underwriters Agency of New England Reinsurance Corp. v. Travelers Ins. Co.*, 803 F.2d 1308, 1314 n.5 (3rd Cir. 1986). *But see, Reliance Ins. Co. v. Moessner*, 121 F.3d 895 (3rd Cir. 1997) (under Pennsylvania law, insured's status as sophisticated purchaser of insurance would not foreclose application of reasonable expectations doctrine to determine scope of coverage if insurer unilaterally inserted provision to insurance policy despite insured's request for coverage).

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§6.4 Preprinted Form and "Manuscript" Policies

Policies can be preprinted, typewritten, or some combination of the two. The term "manuscript" may be used to refer to typewritten policies. Often, these "manuscript" policies are identical in all material respects to the pre-printed forms, the only difference being modifications to fit the peculiarities of a given policyholder. As a general rule, the above rules do not change depending on whether the form of the policy is preprinted or typed. It is the substance of the wording at issue which governs.

7. MISSING POLICIES

§7.1 The Issue

With the advent of toxic tort litigation, which often involves releases of chemicals decades in the past, it has become commonplace for policyholders to submit claims under policies issued and in effect years ago. Often neither the policyholder nor the insurance company can locate certain of these policies. These policies are referred to as "missing policies."

§7.2 Prerequisites for Use of Secondary Evidence and Burdens of Proof

A party has the burden of proof as to a fact, "the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting."[207] This general rule applies with equal force to contracts of insurance.

Where a policy is not available, the policyholder has the burden of proving the existence of any provision granting coverage; insurance companies have the burden of proving the existence of any provision they contend limits or excludes coverage. As one federal court stated in applying Michigan law, "the insurer bears the burden of establishing the existence and applicability of any exclusion from coverage under the terms of its policy."[208] However to prevail on summary judgment, the insurer must provide secondary evidence of all relevant terms and conditions.[209]

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207 *See, e.g.*, California Evidence Code § 500.

208 *Domtar, Inc. v. Niagara Fire Ins. Co.*, 552 N.W.2d 738 (1996). *See also, Caterpillar, Inc. v. Aetna Cas. & Sur. Co.*, 668 N.E.2d 1152 (Ill. App. 1996); *Burroughs Wellcome Co. v. Commercial Union Ins. Co.*, 632 F. Supp. 1213, 1223 (S.D.N.Y. 1986); *Cotton States Mut. Ins. Co. v. American Mut. Liab. Ins. Co.*, 140 Ga. App. 657, 658, 231 S.E.2d 553 (1976).

209 *Burt Rigid Box Inc. v. Travelers Property Cas. Corp*., 126 F. Supp. 2d 596 (W.D.N.Y. 2001) (finding sufficient secondary evidence of coverage based upon the testimony of employees of the insurer, policyholder and insurance broker as well as claims correspondence, correspondence between the insurer, policyholder and insurance broker, and financial statements of the insured); *Caterpillar, Inc. v. Aetna Cas. & Sur. Co.*, 668 N.E.2d 1152 (Ill. App. 1996) (summary judgment in favor of insurer as to missing

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A party may sustain its burden by use of secondary evidence.[210] Some courts describe the party's burden by reference to a "clear and convincing" standard.[211] Others refer to the "preponderance of the evidence standard."[212] As Professor McCormick has written, all that is required is "the best obtainable evidence."[213] There is no "return to the bygone and unlamented days in which to lose one's paper was to lose one's right."[214] For these reasons, as a precondition to proffering secondary evidence of the terms in an insurance policy, the policyholder need only demonstrate that a reasonably diligent search was unable to locate the original.[215]

There are two components to proof respecting missing policies: (1) proving that the policy was issued and the effective dates and limits of the policy, and (2) proving pertinent wordings. The first comes from secondary evidence of the existence of the policies such as references in other policies, or correspondence, ledger books or premium statements; these must be authenticated in the same fashion as all other evidence.[216] The second may be proved through testimony of witnesses who saw the policies or experts specializing in insurance.[217] As one court

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policies reversed because under Illinois law, policyholder bears burden of proving existence and terms and therefore policies were not before court on insurer's motion).

210 *Americhem Corp. v. St. Paul Fire and Marine Ins. Co.*, 942 F. Supp. 1143 (W.D. Mich. 1995); Fed. R. Evid. 1002, 1004.

211 *UTI Corp. v. Fireman's Fund Ins. Co.*, 896 F. Supp. 362 (D.N.J. 1995).

212 *See, e.g.*, *The Lincoln Elec. Co. v. St. Paul Fire and Marine Ins. Co*., 210 F.3d 672 (6th Cir. 2000) (holding preponderance of the evidence standard should be applied because it "makes practical sense, appears to represent the majority rule, and can be said to reasonably anticipate the Ohio Supreme Court's position."); *Americhem, Corp. v. St. Paul Fire and Marine Ins. Co.*, 942 F. Supp. 1143 (W.D. Mich. 1995); *Borough of Sayreville v. Bellfonte Ins. Co*., 728 A.2d 225 (N.J. Super. Ct. App. Div. 1998); *Rubenstein v. Royal Ins. Co*., 694 N.E.2d 381, 384 (Mass. App. Ct. 1998); *Gold Fields American Corp. v. Aetna Cas. & Sur. Co.*, 661 N.Y.S.2d 948 (1997); *Remington Arms Co. v. Liberty Mut. Ins. Co.*, 810 F. Supp. 1420, 1426 (D. Del. 1992).

213 2 *McCormick on Evidence*, p. 76 (4th ed. 1992).

214 *Id.*

215 *See, e.g.*, *Burt Rigid Box Inc. v. Travelers Property Cas. Corp*., 126 F. Supp. 2d 596 (W.D. N.Y. 2001); *Americhem, Corp. v. St. Paul Fire and Marine Ins. Co.*, 942 F. Supp. 1143 (W.D. Mich. 1995); *Gold Fields American Corp. v. Aetna Cas. & Sur. Co.*, 661 N.Y.S.2d 948 (1997) (standard specimen forms may show terms).

216 *See N.H. Ins. Co. v. Rouselle*, 732 A.2d 111 (R.I. 1999) (standard form policy); *Rubenstein v. Royal Ins. Co*., 694 N.E.2d 381 (Mass. App. Ct. 1998) (internal company memoranda); *Allstate Ins. Co. v. Ramirez*, 618 N.Y.S.2d 396 (App. Div. 1994) (state motor vehicle registration record); *New York v. Blank*, 820 F. Supp. 697 (N.D.N.Y. 1993) (sample policy)

217 *Zurich Ins. Co. v. Northbrook Excess & Surplus Ins. Co.*, 145 Ill. App. 3d 175, 201, 494 N.E.2d 634, 652 (1986), *aff'd.*, 118 Ill.2d 23, 514 N.E.2d 150 (1987).

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has stated: "It is not necessary, in order to admit evidence of the contents of a lost instrument, that the witnesses should be able to testify with verbal accuracy to its contents. It is sufficient if they are able to state it in substance."[218]

Where there is a genuine issue of material fact regarding the policy terms, the issue is for a trier of fact, not the court by summary judgment.[219]

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218 *Kenniff v. Caulfield*, 140 Cal. 34, 43, 73 P. 803, 805 (1903).

219 *UTI Corp. v. Fireman's Fund Ins. Co*., 896 F. Supp. 362 (D.N.J. 1995) (stating that insured produced enough evidence to survive summary judgment and for jury to consider lost policy issue); *Servants of Paraclete, Inc. v. Great American Ins. Co.*, 857 F. Supp. 822, 829 (D.N.M. 1994), *amended at* 866 F. Supp. 1560 (1994) ("insured had presented sufficient evidence regarding the existence and terms of the subject policies, which 'if believed at trial, might establish the material terms.'"), *Americhem Corp. v. St. Paul Fire and Marine Ins. Co.*, 942 F. Supp. 1143, 1995 (W.D. Mich. 1995).

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I. INTRODUCTION

"Business interruption" insurance refers to a provision commonly present in commercial property insurance policies by which the insurer agrees to compensate the policyholder for income lost or diminished as a result of an interruption of business caused by covered property damage.[1] This coverage is intended to protect the earnings that the insured would have enjoyed had there been no interruption of business.[2] Covered risks may include: fire, power failures, explosion, accidental damage to equipment and machinery, riot and civil commotion, order of civil authority, earthquakes, or the elements.[3]

II. BUSINESS INTERRUPTION INSURANCE: GENERAL CONSIDERATIONS

A. Policy Language

Coverage for an interruption to business is often provided by way of a provision within, or an endorsement or rider to, a business property insurance policy. Language can vary from policy to policy and the scope of coverage accordingly will depend on the specific language in the policy under which the claim is made. Representative language follows:

> We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by direct physical loss or damage to property, including personal property in the open (or in a vehicle) within 100 feet, at a premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or

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1 *Northwestern States Portland Cement Co. v. Hartford Fire Ins. Co.*, 360 F.2d 531 (8th Cir. 1966); *Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of New York*, 975 F.Supp. 1124 (S.D. Ill. 1997); *Gordon Chemical Co. v. Aetna Cas. & Sur. Co.*, 358 Mass**.** 632, 266 N.E.2d 653 (1971) (the purpose of the policy is to preserve the continuity of the insured's earnings); *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1970).

2 *Lyon Metal Products, L.L.C. v. Protection Mut. Ins. Co*., 321 Ill. App. 3d 330, 747 N.E.2d 495 (2001); *Keetch v. Mutual of* Enumclaw *Insurance Co.*, 66 Wash. App. 208, 831 P.2d 784 (1992).

3 *See infra* at footnotes 32 to 38. *Farmers Chemical Assoc. v. Maryland Casualty Co.*, 421 F.2d 319 (6th Cir. 1970) (faulty construction); *Burdett Oxygen Co. v. Employers Surplus Lines Ins. Co.*, 419 F.2d 247 (6th Cir. 1969) (damage to air compressor requiring shutdown); *Lyon Metal Products, L.L.C. v. Protection Mut. Ins. Co*., 321 Ill. App. 3d 330, 747 N.E.2d 495 (2001) (flood damage); *Anderson & Middleton Lumber Co. v. Lumbermen's Mut. Casualty Co*., 53 Wash. 2d 404, 333 P.2d 938 (1959) (accidental breaking of a bandsaw wheel); *New England Gas & Electric Ass'n v. Ocean Acci. & Guarantee Corp*., 330 Mass. 640, 116 N.E.2d 671 (1953) (accidental damage to machinery and equipment).

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> damage must be covered by or result from a Covered Cause of Loss.[4]
>
> "Business Income" is often defined as:
>
> > a. Net Income (Net profit or Loss before income taxes) that would have been earned or incurred; and
> >
> > b. Continuing normal operating expenses incurred, including payroll.[5]

This coverage may require that the loss result: directly[6] from a covered peril, which must cause damage or destruction to specified property[7] at a particular location.[8] Further, the interruption must be reasonably limited in duration,[9] and must occur within a particular time frame.[10] See Part III, *infra*.

B. All Risk v. Named Perils

Business interruption coverage may be issued on an "all risk" basis or on a "named peril" basis. The former, as its name suggests, insures a business interruption resulting

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4 Business Income and Extra Expense Coverage Form, ISO Form No. CP 00 30 06 95.

5 *Id*.

6 *Keetch v. Mutual of Enumclaw Insurance Co*., 66 Wash. App. 208, 831 P.2d 784 (1992) (holding business interruption insurance does not indemnify a business for reduced earnings incurred from damages which only indirectly impact the ability of the business to continue to operate even though it is only able to continue a portion of its normal operations and its quality of service is reduced during this period of partial operations).

7 *Swedish Crucible Steel Co. v. Travelers Indem. Co*., 387 F.Supp. 231 (E.D. Mich. 1974).

8 *Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co*., 835 F.2d 812 (11th Cir. 1988) (no coverage for decline in room occupancy at an insured hotel, where the decline was a result of a fire on the premises of the insured's restaurant and hotel restaurant was the only covered location and no mutual dependency between the hotel room and the restaurant); *Learfield Communications, Inc. v. Hartford Acci. & Indem. Co*., 837 S.W.2d 299 (Mo. App. 1992); *Gregory v. Continental Ins. Co.*, 575 So. 2d 534 (Miss. 1990) (a policy insuring a building at a golf course, covering losses from an interruption of business caused by damage or destruction of property at the insured premises due to the perils insured against, did not cover business losses at the insured premises resulting from the golf course itself being shut down).

9 *Keetch v. Mutual of Enumclaw Ins. Co*., 66 Wash. App. 208, 831 P.2d 784 (1992).

10 *Pennbarr Corp. v. Insurance Co. of North America*, 976 F.2d 145 (3rd Cir. 1992); *Hampton Foods, Inc. v. Aetna Casualty & Surety Co*., 843 F.2d 1140 (8th Cir. 1988).

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from all risks except any specifically excluded ones.[11] The latter covers business interruption which results from certain enumerated causes.[12]

C. Valued Policies v. Open Policies

Business interruption insurance policies come in two varieties: "valued" or "open." "Valued" policies are those in which the insurer and the insured predetermine the amount of loss covered by the policy.[13] If a total loss of the insured property occurs, then the insurance company pays the stipulated value; the actual value is irrelevant.[14] For example, in one case the insured and insurer stipulated a value of the ongoing business at $3,260 per day, with a limit of 180 working days total loss allowed to be claimed.[15]

"Open" policies are those which do not specify the final amount to be paid; the value of a recoverable loss will be determined through a show of evidence.[16] However, even with open policies, there often is a predetermined cap on the amount of coverage available. [17]

D. "Business Interruption" v. "Use and Occupancy"

"Use and occupancy" insurance presaged modern business interruption insurance. It was attached to property insurance policies via endorsements or riders and insured the use and occupancy of the property against damage or loss.[18] "Use and occupancy" insurance and "business interruption" insurance are often used interchangeably.[19] Like business interruption policies, the use and occupancy endorsement serves the same functions: it protects the payment

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[11] *See, e.g., Insurance Co. of North America, Inc. v. U.S. Gypsum Co., Inc*., 870 F.2d 148 (4th Cir. 1989); *Hampton Foods, Inc. v. Aetna Casualty & Surety Co*., 843 F.2d 1140 (8th Cir. 1988) (coverage extended to "all risks of direct physical loss"); *Great Northern Oil Co. v. St. Paul Fire & Marine Ins. Co.*, 303 Minn. 267, 227 N.W.2d 789 (1975) (coverage extended to "all risks of physical loss or damage").

[12] *See, e.g., Gregory v. Continental Ins. Co*., 575 So. 2d 534 (Miss. 1990) (business interruption coverage limited to "the perils insured against").

[13] *Polytech, Inc. v. Affiliated FM Ins. Co*., 21 F.3d 271 (8th Cir. 1994); *Omaha Paper Stock Co. v. Harbor Ins. Co.*, 596 F.2d 283 (8th Cir. 1979).

[14] *Clark v. Aetna Cas. & Sur. Co.*, 778 F.2d 242 (5th Cir. 1985).

[15] *Omaha Paper Stock Co. v. Harbor Ins. Co*., 596 F.2d 283 (8th Cir. 1979).

[16] *Eisenson v. Home Ins. Co*., 84 F.Supp. 41 (D.C. Fla. 1949); *National Fire Ins. Co. v. Hutton*, 396 S.W.2d 53 (1965).

[17] *Stuyvesant Ins. Co. v. Jacksonville Oil Mill*, 10 F.2d 54 (6th Cir. 1926).

[18] Borghesi, *Business Interruption Insurance--A Business Perspective*, 17 Nova L. Rev. 1147 (1993).

[19] *Nickals v. Ohio Farmers Ins. Co*., 237 F.Supp. 904 (N.D. Cal. 1965).

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of profits and legitimate continuing charges or expenses in the event of loss or destruction of the property insured.[20]

E. Rules of Policy Construction

When interpreting business interruption coverage, courts apply the same rules of construction that they use when construing other types of insurance coverage.[21] For example, the insurance contract should be interpreted to give practical effect to the intentions of the parties;[22] where the policy language is ambiguous and susceptible to two reasonable interpretations, it should be construed in a manner favorable to the insured and against the insurer;[23] exclusions within the policy will be strictly construed against the insurer;[24] all parts of the policy are to be considered together in order to ascertain the meaning and intent of the parties;[25] where both a general and a specific provision of the policy address the same subject, the more specific clause controls;[26] the language of the parties should be given its plain and ordinary meaning;[27] and the policy language is given the meaning which a person of ordinary intelligence would attribute to it.[28]

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20 *Springfield Fire & Marine Ins. Co. v. J. T. Wilson Co.*, 67 F.2d 426 (6th Cir. 1933); *Fidelity-Phoenix Fire Ins. Co. v. Benedict Coal Corp.*, 64 F.2d 347 (4th Cir. 1933); *Wilson & Toomer Fertilizer Co. v. Automobile Ins. Co.*, 283 F. 501 (D.C. Fla. 1922).

21 *Travelers Indem. Co. v. Kassner*, 322 So. 2d 80 (Fla. App. 1975).

22 *National Union Fire Ins. Co. v. Anderson-Prichard Oil Corp.*, 141 F.2d 443 (10th Cir. 1944); *Foote Mineral Co. v. Maryland Casualty Co*., 173 F.Supp. 925 (D.C. Tenn. 1959); *Travelers Indem. Co. v. Kassner*, 322 So. 2d 80 (Fla. App. 1975); *Anderson & Middleton Lumber Co. v. Lumbermen's Mut. Casualty Co*., 53 Wash. 2d 404, 333 P.2d 938 (1959).

23 *Hampton Foods, Inc. v. Aetna Casualty & Surety Co*., 787 F.2d 349 (8th Cir. 1986); *Burdett Oxygen Co. v. Employers Surplus Lines Ins. Co.*, 419 F.2d 247 (6th Cir. 1969); *National Children's Expositions Corp. v. Anchor Ins. Co*., 279 F.2d 428 (2nd Cir. 1960); *Grevas v. United States Fidelity & Guar. Co*., 152 Ill. 2d 407, 604 N.E.2d 942 (1992); *Learfield Communications, Inc. v. Hartford Acci. & Indem. Co.*, 837 S.W.2d 299 (Mo. App. 1992); *Pressman v. Aetna Casualty & Sur. Co.*, 574 A.2d 757 (R.I. 1990); *Travelers Indem. Co. v. Kassner*, 322 So. 2d 80 (Fla. App. 1975); *Washington Restaurant Corp. v. General Ins. Co*., 64 Wash. 2d 150, 390 P.2d. 970 (1964); *Foote Mineral Co. v. Maryland Casualty Co.*, 173 F.Supp. 925 (D.C. Tenn. 1959).

24 *Kilroy Industries v. United Pacific Ins. Co*., 608 F.Supp. 847 (C.D. Cal. 1985).

25 *Grevas v. United States Fidelity & Guar. Co.*, 152 Ill. 2d 407, 604 N.E.2d 942 (1992).

26 *Id*.

27 *Burdett Oxygen Co. v. Employers Surplus Lines Ins. Co.*, 419 F.2d 247 (6th Cir. 1969).

28 *Hampton Foods, Inc. v. Aetna Casualty & Surety Co*., 787 F.2d 349 (8th Cir. 1986); *Burdett Oxygen Co. v. Employers Surplus Lines Ins. Co.*, 419 F.2d 247 (6th Cir. 1969); *National Children's Expositions Corp. v. Anchor Ins. Co*., 279 F.2d 428 (2nd Cir. 1960).

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F. Notice and Proof of Loss

As with other claims under property policies, the insured must file a proof of loss for business interruption claims.[29] However, an insurer may waive the notice and proof requirement by denying coverage during the period for filing the notice and proof.[30]

III. COVERAGE

A. Scope of Coverage

For an insured to recover under this coverage, the insured must show: (1) a named risk (if the policy is not an "all risk" policy) (2) directly produced physical loss or damage to covered property, which (3) interrupted the business (4) and caused a loss of business income, (5) at a covered location.[31]

It should be noted at the outset that business interruption coverage is less standardized than other types of insurance. For this reason, legal counsel for policyholders should carefully compare their policy language with the language analyzed in judicial decisions and ascertain that it is similar. In addition, policyholders and their legal counsel should always examine closely the policy language contained in existing policies and when buying a new policy, seek coverage specifically tailored to the needs and anticipated risks of each individual business.

1. Insurable Risks

The risk most commonly insured against in a business interruption policy is fire.[32] Other commonly insured risks include power failures,[33] explosions,[34] earthquakes,[35] order of civil authority,[36] riot and civil commotion,[37] and floods.[38]

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29 *Victory Cabinet Co. v. Insurance Co. of North America*, 183 F.2d 360 (7th Cir. 1950).

30 *Emersons, Ltd. v. Max Wolman Co.*, 388 F.Supp. 729 (D.C. Dist. Col. 1975).

31 *Diamond Shamrock Corp. v. Lumbermens Mut. Casualty Co.*, 466 F.2d 722 (7th Cir. 1972); *Charles Dowd Box Co. v. Fireman's Fund Ins. Co.*, 351 Mass. 113, 218 N.E.2d 64 (1966); *St. Joseph Light & Power Co. v. Zurich Ins. Co.*, 698 F.2d 1351 (8th Cir. 1983); *Hart-Bartlett-Sturtevant Grain Co. v. Aetna Ins. Co.*, 365 Mo. 1134, 293 S.W.2d 913 (1956); *Howard Stores Corp. v. Foremost Ins. Co.*, 82 App. Div. 2d 398, 441 N.Y.S.2d 674 (1981); *National Children's Expositions Corp. v. Anchor Ins. Co.*, 279 F.2d 428 (2nd Cir. 1960); *Lakewood Mfg. Co. v. Home Ins. Co.*, 422 F.2d 796 (6th Cir. 1970); *Cleland Simpson Co. v. Firemen's Ins. Co.*, 392 Pa. 67, 140 A.2d 41 (1958); *Foote Mineral Co. v. Maryland Casualty Co.*, 173 F.Supp. 925 (D.C. Tenn. 1959). *See also, supra,* notes 6 to 10.

32 *See, e.g., Swedish Crucible Steel Co. v. Travelers Indem. Co.*, 387 F. Supp. 231 (E.D. Mich. 1974); *Washington Restaurant Corp. v. General Ins. Co.* (1964) 64 Wash. 2d 150, 390 P.2d 970.

33 *Manufacturers Mut. Fire Ins. Co. v. Royal Indem. Co.*, 501 F.2d 299 (9th Cir. 1974).

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2. Physical Loss or Damage To Covered Property

Policies do not cover business interruption as an insured event *per se*; they cover business interruption as a form of damage arising from covered property damage. It follows that as a predicate to coverage for this type of loss, there must be covered physical loss of or damage to specified property. Business interruption coverage does not provide indemnity for physical loss of or damage to the property itself; this is the function of property insurance.[39]

This is an area where the policy language varies from policy to policy and courts issue divergent and confusing decisions. For instance, in one case the court determined that repeated references such as "damage to or destruction of personal property … on the premises occupied by the insured and situated herein" and "following the date of damage to or destruction

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[34] *National Children's Expositions Corp. v. Anchor Ins. Co.*, 279 F.2d 428 (2nd Cir. 1960); *American Alliance Ins. Co. v. Keleket X-Ray Corp.*, 248 F.2d 920 (6th Cir. 1957); *Nitrin, Inc. v. American Motorists Ins. Co*., 94 Ill. App. 2d 197, 236 N.E.2d 737 (1968); *Waldridge Hosiery Mill, Inc. v. Hartford Steam Boiler Inspection & Ins. Co.*, 386 S.W.2d 938 (Ark. 1965); *Hart-Bartlett-Sturtevant Grain Co. v. Aetna Ins. Co*., 293 S.W.2d 913 (Mo. 1956); *Roddis Lumber & Veneer Co. v. American Alliance Ins. Co*., 47 N.W.2d 23 (Mich. 1951).

[35] *Kilroy Industries v. United Pacific Ins. Co.*, 608 F.Supp. 847 (C.D. Cal. 1985); *National Children's Expositions Corp. v. Anchor Ins. Co.*, 279 F.2d 428 (2nd Cir. 1960); *Gilbert/Robinson, Inc. v. Sequoia Ins. Co.*, 655 S.W.2d 581 (Mo. App. 1983).

[36] *Sloan v. Phoenix of Hartford Ins. Co*., 46 Mich. App. 46, 207 N.W.2d 434 (1973); *Southlanes Bowl, Inc. v. Lumbermen's Mut. Ins. Co.*, 46 Mich. App. 758, 208 N.W.2d 569 (1973); *Allen Park Theatre Co. v. Michigan Millers Mut. Ins. Co.*, 48 Mich. App. 199, 210 N.W.2d 402 (1973); *Adelman Laundry & Cleaners, Inc. v. Factory Ins. Ass'n*., 59 Wis. 2d 145, 207 N.W.2d 646 (1973); *Two Caesars Corp. v. Jefferson Ins. Co.*, 280 A.2d 305 (Dist. Col. App. 1971); *Bros., Inc. v. Liberty Mut. Fire Ins. Co*., 268 A.2d 611 (Dist. Col. App. 1970); *Cleland Simpson Co. v. Firemen's Ins. Co.*, 392 Pa. 67, 140 A.2d 41 (1958).

[37] *Palace Cafe v. Hartford Fire Ins. Co.*, 97 F.2d 766 (7th Cir. 1938).

[38] *Lyon Metal Products, L.L.C. v. Protection Mut. Ins. Co*., 321 Ill. App. 3d 330, 747 N.E.2d 495 (2001); *Gilbert/Robinson, Inc. v. Sequoia Ins. Co.*, 655 S.W.2d 581 (Mo. App. 1983).

[39] *Polytech, Inc. v. Affiliated FM Ins. Co.*, 21 F.3d 271 (8th Cir. 1994); *Northwestern States Portland Cement Co. v. Hartford Fire Ins. Co.*, 360 F.2d 531 (8th Cir. 1966); *Quality Molding Co. v. American Nat'l Fire Ins. Co.*, 272 F.2d 779 (7th Cir. 1959); *Hudson Mfg. Co. v. New York Underwriters' Ins. Co.*, 33 F.2d 460 (7th Cir. 1929); *Victory Container Corp. v. Sphere Ins. Co.*, 448 F.Supp. 1043 (D.C. N.Y. 1978); *America Southwest Corp. v. Underwriters at Lloyds, London*, 333 F.Supp. 1333 (S.D. Miss. 1971); *Gordon Chemical Co. v. Aetna Casualty & Surety Co.*, 358 Mass. 632, 266 N.E.2d 653 (1971); *Jarvis Towing & Transp. Corp. v. Aetna Ins. Co.*, 72 N.Y.S.2d 696 (Sup. 1947); *Puget Sound Lumber Co. v. Mechanics' & Traders' Ins. Co.*, 168 Wash. 46, 10 P.2d. 568 (1932); *Michael v. Prussian Nat'l Ins. Co.*, 171 N.Y. 25, 63 N.E. 810 (1902); *Chatfield v. Aetna Ins. Co.*, 71 App. Div. 164, 75 N.Y.S. 620 (1902).

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of the real or personal property described" mandated a holding that physical damage is a necessary condition precedent to recovery under the policy.[40] In that case, the court denied a plastics and foundry manufacturing business recovery for a fire that originated in an uninsured building which caused a loss of various molds, dyes, and patterns at the insured building because the latter building was not physically damaged.[41] In another case, recovery was denied where the insured shut down its operations due to the mayor's order that all stores in the city close their doors (a hurricane caused serious fire danger).[42] The majority affirmed the trial court's decision that the policy required actual loss as a direct result of destruction caused by fire. An impassioned dissent argued that the policy language, which provided for recovery when the order of civil authority prevented access to the premises as a direct result of "a peril insured against," that there did not need to be destruction from fire for recovery, rather, the policy required only the danger of a possible fire. Other jurisdictions have opined that actual physical damage is not necessary in all instances. The Second Circuit, in a case where a severe snowstorm drastically reduced attendance at an exposition, explained, in dicta: "[I]f the snowstorm resulted in a power shut-off which prevented the holding of the exposition in all or part of the building, there would be loss within the terms of the policy."[43]

Other policies contain language (in addition to the "physical loss or damage" language) which maintains coverage extends to "include actual loss as covered when as a direct result of a peril insured against the premises in which the property is located is so damaged as to prevent access to such property."[44] In *Datatab, Inc. v. St. Paul Fire & Marine Ins. Co.*,[45] a water main broke in the basement of the building in which Datatab was located. The break in the water main caused damage to several water pumps which in turn caused damage to Datatab's air conditioning system. The breakdown of the air conditioning system forced a shutdown of the Datatab's computers. The insurer argued that because there was no direct physical damage to the Datatab office space (which were located on the upper floors of the building) and because physical access to the computers was unimpaired, there was no coverage for the interruption of Datatab's business under the terms of the policy. Datatab argued, and the court agreed, that the language of the policy should be construed more broadly; that under the terms of the policy, the word "premises" referred to the entire building, not just the floors on which the machinery was located, and the word "access" referred not to the physical ability to enter the computer room, but to the ability to utilize the equipment normally used in the operation of its business.[46]

The "physical" loss or damage requirement gives rise to several interesting sub-issues important to policyholders. For instance, courts are divided on whether a governmental

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40 *Swedish Crucible Steel Co. v. Travelers Indem. Co.*, 387 F.Supp. 231 (E.D. Mich. 1974).

41 *Id*.

42 *Cleland Simpson Co. v. Firemen's Ins. Co.*, 392 Pa. 67, 140 A.2d 41 (1958).

43 *National Children's Expositions Corp. v. Anchor Ins. Co.*, 279 F.2d 428 (2nd Cir. 1960).

44 *Datatab, Inc. v. St. Paul Fire & Marine Ins. Co.*, 347 F.Supp. 36 (S.D. N.Y. 1972).

45 *Id*.

46 *Id*. Accord, *Linnton Plywood Ass'n v. Protection Mut. Ins. Co.*, 760 F.Supp. 170 (D.C. Or. 1991).

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order closing down a business satisfies this element. Policies may include coverage for the imposition of civil authority.[47] Such coverage typically protects the policyholder from actual loss of business income sustained plus extra expenses due to action of civil authority which blocks access to the covered property due to direct physical loss or damage to other property caused by a covered cause of loss.[48] Some courts have found coverage for business interruption losses due to closure ordered by a civil authority, holding that physical damage to the covered location is not a prerequisite to recovery.[49] In one case, the policy made no explicit mention of a necessity of physical damage for recovery.[50] Those courts which have denied coverage do so by strictly construing the "direct physical loss or damage to" language, holding that a governmental order does not equate to damage to physical property.[51] For instance, in one case the insured sought recovery for closing down its theaters as a result of the dawn-to-dusk curfews imposed during the aftermath of the Rodney King riots.[52] The court denied recovery because the policy language required the interruption to be "a direct result of damage to or destruction of property adjacent" and the insured opted to close its theaters as a result of the city-wide curfews not as a result of adjacent property damage.[53]

This issue was especially relevant in the aftermath of the terrorist attacks on New York City and Washington, D.C. In this age of heightened alert, a business must seek to protect itself from the losses that may be incurred as a result of a government-ordered evacuation or other imposition of civil authority. The problem faced by businesses indirectly affected by the terrorist attacks is that the damage is to a separate, unconnected property or locale. Recovery typically depends on a covered property being damaged.[54] For instance, in *Gregory v. Continental Ins. Co.*,[55] the policy specifically insured the restaurant and pro shop at a golf course—but not the golf course itself—for losses from an interruption of business caused by damage or destruction of property at the insured building. The policyholder sought coverage for business interruption due to damage from a hurricane which resulted in closure of the golf

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47 Jean M. Lawler and Kenneth E. Goates, *No Assurances*, 25 Los Angeles Lawyer 39, 45-46 (September 2002).

48 *Id*. at 46.

49 *Southlanes Bowl, Inc. v. Lumbermen's Mut. Ins. Co.*, 46 Mich. App. 758, 208 N.W.2d 569 (1973).

50 *Sloan v. Phoenix of Hartford Ins. Co.*, 46 Mich. App. 46, 207 N.W.2d 434 (1973).

51 *Adelman Laundry & Cleaners, Inc. v. Factory Ins. Ass'n.*, 59 Wis 2d 145, 207 N.W.2d 646 (1973); *Two Caesars Corp. v. Jefferson Ins. Co.*, 280 A.2d 305 (Dist. Col. App. 1971); *Bros., Inc. v. Liberty Mut. Fire Ins. Co.*, 268 A.2d 611 (Dist. Col. App. 1970); *Cleland Simpson Co. v. Firemen's Ins. Co.*, 392 Pa. 67, 140 A.2d 41 (1958).

52 *Syufy Enterprises v. Home Ins. Co.*, 1995 U.S. Dist. LEXIS 3771 (N.D. Cal. 1995).

53 *Id*.

54 *See Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co. of America*, 835 F.2d 812 (11th Cir. 1988) (holding an insured could not recover for decline in occupancy of a hotel which remained open following a fire in the restaurant).

55 575 So. 2d 534 (Miss. 1990).

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course. The court held that the policy did not cover business losses at the insured premises resulting from the golf course itself being shut down.[56] Another hurdle policyholders might face is the insurer's invocation of the war risk exclusion if so contained in the policy.[57] No reported case has interpreted this exclusion in the context of business interruption coverage. However, there has been some explication of this exclusion in light of property insurance policies.[58]

In order to bolster the case for the recovery of losses due to closure without physical damage as a result of an order of civil authority, policyholders can look to decisions such as *Hampton Foods, Inc. v. Aetna Casualty & Surety Co*.[59] In that case, the insured, a grocery store operator, was ordered to vacate the store by the city building commissioner because the building was in danger of collapsing. The Eighth Circuit affirmed the lower court's decision in favor of the insured, finding that the policy language covering loss or damage "resulting from all risks of direct physical loss" was ambiguous. Rejecting the insurer's argument that the policy required a direct physical loss, the court noted that the ordinary person would understand the policy to provide coverage for any loss or damage due to the danger of direct physical loss. Contingent business interruption policies may also provide coverage. This coverage insures the policyholder against losses resulting from physical damage to the policyholder's suppliers' or customers' properties. This type of coverage is examined further in Section III.C, *infra*.

Yet another modern-age problem for the business owner is the issue of whether computer failure or corruption leading to an interruption in business satisfies the "physical loss or damage" element.[60] Insurers will argue that events such as hacking, program errors, and the corruption of files due to viruses are not physical damage, or at the very least, that loss or

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56 *Id*. *See also* §III.A.5, *infra*.

57 *See Compagnie des Bauxites de Guinee v. Insurance Co. of North Am.*, 721 F.2d 109 (3rd Cir. 1983) (incidentally citing the policy's exclusions: "This policy does not insure against: … (d) Insurrection, rebellion, revolution, civil wars, usurp of power, or action taken by governmental authority in hindering, combating, or defending against such an occurrence, seizure or destruction under quarantine or customs regulations, confiscation by order of any government or public authority, or risks of contraband or illegal transportation or trade.").

58 *See, generally*, 10 *Couch On Insurance*, Chapter 152 (3d ed. 1998)

59 787 F.2d 349 (8th Cir. 1986).

60 *See Pressman v. Aetna Cas. & Surety Co.*, 574 A.2d 757 (R.I. 1990) (finding that a power outage preventing a doctor from using his office due to the failure of a computer chip was a business interruption). But see *Home Indem. Co. v. Hyplains Beef*, 893 F. Supp. 987 (D.Kan. 1995) (abstaining from deciding whether claim for lost business income arising from an alleged loss of electronic data constituted a "direct physical loss" because there was never a "necessary suspension" of the insured's operations as required by the policy).

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damage has not yet occurred.[61] However, insureds can analogize to the established availability of coverage for other sub-visible forms of damage.[62]

3. Interruption in Business

The generally accepted rule is that the period of business interruption begins at the time of the underlying physical damage. The Eighth Circuit has noted that an insured's recovery must be restricted to the loss of income that would have been earned during the reconstruction period, even though there may have been a substantial additional, but uninsured, loss consisting of reduction in income subsequent to the date of full restoration.[63] Conversely, increased costs are only covered if they arise during the period of business interruption, not those arising after the interruption.[64] There must be a definite cut-off period; otherwise the coverage period could extend indefinitely.

One of the more commonly litigated issues as to the interruption in business requirement is whether a *reduction* in business is sufficient to trigger coverage. The general rule is that a reduction in business does not satisfy the "necessary interruption" language; rather there need be an actual suspension of business operations.[65] An excellent example of this can be found in the Second Circuit's decision in *National Children's Expositions Corp. v. Anchor Ins. Co.*[66] In that case, the court held there was no partial business interruption loss because the insured's building was open during the entire period when an unprecedented snow storm reduced

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61 Scott P. DeVries, *Insurance Coverage For Year 2K Expense Under First Party "All Risk" Policies*, Andrews Publications (1999)

62 *Id. See also, e.g., Farmers Ins. Co. of Oregon v. Trutanich*, 858 P.2d 1332 (Or. App. 1993) (holding that the cost of removing odors from methamphetamine plant caused physical damage to home due to loss of use).

63 *Rogers v. American Ins. Co.*, 338 F.2d 240 (8th Cir. 1964)

64 *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr.122 (1970).

65 *See Compagnie des Bauxites de Guinee v. Insurance Co. of North Am.*, 721 F.2d 109 (3rd Cir. 1983); *Quality Oilfield Products, Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635 (1998) (holding work slowdown was not "interruption of business"); *Royal Indem. Ins. Co. v. Mikob Properties, Inc.*, 940 F.Supp. 155 (S.D.Tex. 1996) (holding under Texas law, business interruption insurance would not cover loss of income from adjacent buildings which were adversely affected by a fire because the insured never suspended operations on the adjacent buildings); *Keetch v. Mutual of Enumclaw Ins. Co.*, 66 Wash.App. 208, 212, 831 P.2d 784, 787 (1992) (holding an insured could not recover when volcanic ash caused damage to motel and quality of service was reduced, but motel never ceased operations); *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1970)(interruption of work on a particular project of a manufacturing company is not an interruption of business where the insured facility as a whole continues to operate).

66 279 F.2d 428 (2d Cir. 1960).

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attendance at an exposition.[67] However, in situations where the insured resumed operations at a reduced level at another location following damage or destruction at a covered location, some courts have rejected the insurer's argument that the suspension in business was only partial; the diminution in business sustained constituted a business interruption for which the insured could recover.[68]

As has been noted, business interruption insurance covers only loss of income. Thus, where the insured experiences a loss of production capacity at a covered location but does not experience lost earnings as a result, there is no recoverable business interruption.[69] But if the insured makes money despite the interruption in business, the insured's recovery is not offset by these earnings even if the earnings would have been made had no business interruption occurred.[70]

4. Loss of Income

By definition, a business interruption policy is intended to cover lost earnings during the period of interruption. The insured must establish a loss of business income or the addition of some other expense. These must be causally related to the suspension of operations rather than to the risk that caused the covered physical damage.[71] Some business interruption policies provide coverage for "lost earnings;" others provide coverage only for "actual loss" the insured suffers. The differences will be explored below.

a) Gross Earnings Less Non-Continuing Expenses

Lost earnings are most commonly defined as gross earnings less normal costs that do not continue as a result of the business interruption ("non-continuing expenses").[72] A court

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67 *Id*.

68 *American Medical Imaging Corp. v. St. Paul Fire & Marine Ins. Co.*, 949 F.2d 690 (3rd Cir. 1991); *Omaha Paper Stock Co. v. Harbor Ins. Co.*, 596 F.2d 283 (8th Cir. 1979); *Hartford Fire Ins. Co. v. Wilson & Toomer Fertilizer Co.*, 4 F.2d 835 (5th Cir. 1925).

69 *Pennbarr Corp. v. Insurance Co. of North America*, 976 F.2d 145 (3rd Cir. 1992)(where the insured, which was able to stretch its inventory to meet sales demand for the full period required to repair earthquake damage at its plant, was denied recovery for loss of sales, occurring after this period, equal to the production it lost as a consequence of the earthquake damage); *Northwestern States Portland Cement Co. v. Hartford Fire Ins. Co.*, 360 F.2d 531 (8th Cir. 1966); *Fold-Pak Corp. v. Liberty Mut. Fire Ins. Co.*, 784 F.Supp. 49 (W.D. N.Y. 1992); *Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co.*, 461 N.W.2d 496 (Minn. App. 1990).

70 *Omaha Paper Stock Co. v. Harbor Ins. Co.*, 596 F.2d 283 (8th Cir. 1979); *United Nuclear Corp. v. Allendale Mut. Ins. Co.*, 103 N.M. 480, 709 P.2d 649 (1985).

71 *Berkeley Inn v. Centennial Ins. Co.*, 422 A.2d 1078 (Pa. 1980); *Pacific Coast Eng'g Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1970).

72 *Associated Photographers, Inc. v. Aetna Cas. & Sur. Co.*, 677 F.2d 1251 (8th Cir. 1982); *Eastern Associated Coal Corp. v. Aetna Cas. & Sur. Co.*, 632 F.2d 1068 (3rd Cir. 1980);

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generally looks to the insured's past performance, as well as its probable future earnings in ascertaining the amount of loss sustained.[73]

Note that "lost earnings" do not necessarily equate with "lost profits," though lost profits could be recoverable depending on the terms of the policy.[74] There is a noteworthy distinction between a policy that insures "earnings" and one that insures "profits" because a business may suffer a compensable loss of gross earnings even in the absence of profit, or even where it was losing money.[75] For example, in *Washington Restaurant Corp. v. General Ins. Co.*,[76] the restaurant's business interruption insurance policy provided coverage for "actual loss sustained to gross earnings," limited to $3,000 per month. "Gross earnings" was undefined within the policy. Damage occurred to the restaurant as the result of a fire. The insurer refused coverage reasoning that the restaurant had been operating on a loss and this loss was reduced during the interruption of business. The court rejected the insurer's reasoning, defining gross earnings as total sales less the cost of goods sold. Consequently, it was not necessary for the store to have any expectation of profit in order to recover lost gross earnings and so it was reasonable to construe the policy to insure the first $3,000 in gross earnings each month, regardless of net profit.

Similarly, other courts hold that it is unnecessary for the insured to have realized actual profits before the loss so long as the insured presents adequate proof of improved profit expectancy during the period of the interruption.[77] But where the insured provides neither, recovery under the policy will be denied.[78]

Gregory v. Continental Ins. Co., 575 So 2d 534 (Miss. 1990); *Haynes v. Standard Fire Ins. Co.*, 370 So. 2d 118 (1979). But see *Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*, 843 F.2d 1140 (8th Cir. 1988), in which "earnings" was defined as profits plus certain expenses.

73 *W. S. Shamban & Co. v. Commerce & Industry Ins. Co.*, 475 F.2d 34 (9th Cir. 1973); *Ross v. Travelers Indem. Co.*, 325 A.2d 768 (Me. 1974); *Georgia-Pacific Corp. v. Allianz Ins. Co.*, 977 F.2d 459 (8th Cir. 1992).

74 *Diamond Shamrock Corp. v. Lumbermens Mut. Cas. Co.*, 466 F.2d 722 (7th Cir. 1972); *Berkeley Inn, Inc. v. Centennial Ins. Co.*, 282 Pa. Super. 207, 422 A.2d 1078 (1980).

75 *See, e.g., Washington Restaurant Corp. v. General Ins. Co.*, 64 Wash. 2d 150, 390 P.2d 970 (1964).

76 *Id*.

77 *Polytech, Inc. v. Affiliated FM Ins. Co.*, 21 F.3d 271 (8th Cir. 1994); *General Ins. Co. v. Pathfinder Petroleum Co.*, 145 F.2d 368 (9th Cir. 1944); *Fidelity-Phoenix Fire Ins. Co. v. Benedict Coal Corp.*, 64 F.2d 347 (4th Cir. 1933); *United Land Investors, Inc. v. Northern Ins. Co.*, 476 So. 2d 432 (1985); *National Union Fire Ins. Co. v. Scandia of Hialeah, Inc.*, 414 So. 2d 533 (Fla. App. 1982); *National Fire Ins. Co. v. Hutton*, 396 S.W.2d 53 (Ky. 1965); *Puget Sound Lumber Co. v. Mechanics' & Traders' Ins. Co.*, 168 Wash. 46, 10 P.2d. 568 (1932). To the contrary, under Florida law, there must be an on-going business with an established sales record and proven ability to realize profits at the established rate in order to

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The other main measure of recovery alongside gross earnings is the insured's continuing necessary expenses.[79]

b) Actual Loss Required

Some policies contain language which requires that the insured suffer an actual loss. Courts have held that actual loss of earnings means the difference between the net profit the insured would have earned during the period of the interruption and the net profit the insured did earn during that period.[80]

c) Mitigation Requirements

Business interruption policies also normally require the insured to take positive steps to mitigate a loss.[81] For example, such policy language might require the insured to "do everything to protect the property from further damage."[82] Some courts consider it not so much a requirement to mitigate damages, as much as a covenant to quickly repair the damage which has interrupted the administration of the insured's business at the covered location.[83]

Since the mitigation requirement is a duty the insured performs for the insurer's benefit, mitigation cost is recoverable so long as it is reasonable and less than the damages would

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recover lost profits under business interruption policy. *Dictiomatic, Inc. v. U.S. Fidelity & Guar. Co.*, 127 F.Supp.2d 1239 (S.D. Fla. 1999) (citing cases).

78 *Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*, 787 F.2d 349 (8th Cir. 1986); *Manduca Datsun, Inc. v. Universal Underwriters Ins. Co.*, 106 Idaho 163, 676 P.2d. 1274 (1984); *Berkeley Inn, Inc. v. Centennial Ins. Co.*, 282 Pa. Super. 207, 422 A.2d 1078 (1980).

79 *See, supra*, § II.A. Other such sample policy language follows: "Due consideration shall be given to the continuation of normal charges and expenses, including payroll expense, to the extent necessary to resume operations of the insured with the same quality of service which existed immediately preceding the loss." *Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co.*, 461 N.W.2d 496 (Minn. Ct. App. 1990).

80 *See, e.g., Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co.*, 461 N.W.2d 496 (Minn. App. 1990).

81 *See. e.g., Insurance Co. of North America, Inc. v. U.S. Gypsum Co., Inc.*, 870 F.2d 148 (4th Cir. 1989) (insured could recover "sue and labor" damages for expenditures which were reasonably incurred in attempting to reduce losses, whether or not those attempts were successful; where estimate for stabilizing plant site was $2,000,000 more than insured spent in replacing plant at another site, costs of relocating and rebuilding plant were fully recoverable).

82 *Witcher Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 550 N.W.2d 1 (Minn. App. 1996).

83 *Omaha Paper Stock Co. v. Harbor Ins. Co.*, 596 F.2d 283 (8th Cir. 1979).

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have been without it.[84] As such, the insured may recover the additional production expenses made necessary by mitigation efforts when the expenses are less than the damages would otherwise have been.[85]

d) Limitations on Recoverable Loss

While an insured may suffer innumerable types of damage as a result of an interruption of business, courts tend to limit recoverable loss under a business interruption policy to lost profits.[86] Many policies specifically exclude remote or consequential forms of damage.[87] For instance, costs such as a penalty that the insured may be required to pay to a customer are generally not covered because they do not occur during the period of the business interruption, and because they do not result directly from the business interruption.[88] However, an insured may be able to recover accrued interest expenses that the insured would have been able to pay had its business not been interrupted.[89]

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[84] *Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co.*, 461 N.W.2d 496 (Minn. Ct. App. 1990).

[85] *Id.* For analogy to coverage for mitigation expense in third party liability context, *see Aerojet-General Corp. v. Superior Court*, 211 Cal. App. 3d 216 (1988).

[86] Courts have rejected bids for various other damages. *See Witcher Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 550 N.W.2d 1 (Minn. App. 1996)(cost of idle workers and equipment; increased costs associated with working at an unplanned, inconvenient time); *Learfield Communications, Inc. v. Hartford Acci. & Indem. Co.*, 837 S.W.2d 299 (Mo. App. 1992)(cost of equipment purchased to prevent or minimize the interruption); *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1970)(increased interest expenses; damages or penalties paid to a customer for failure to finish a project on time; overtime expenses).

[87] *Travelers Indem. Co. v. Pollard Friendly Ford Co.*, 512 S.W.2d 375 (1974); *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr.122 (1970)(no coverage for increased interest expenses; damages or penalties paid to a customer for failure to finish a project on time; overtime expenses).

[88] *See Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1970).

[89] *Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*, 787 F.2d 349 (8th Cir. 1986)(insurer potentially liable for interest on a business loan accruing during the time of the interruption). But see *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1970)(insured's additional loan interest expense, incurred as the result of a delay in the receipt of income caused by a business interruption, was not covered under the insured's business interruption policy).

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e) Burden of Proof

The insured bears a burden in proving the amount of the estimated loss.[90] A business interruption claim is not as simple to compute as physical damage or destruction.[91] This being the case, courts recognize that some speculation is inherent and inevitable.[92] Generally, the insured need not prove its anticipated lost earnings to a reasonable certainty.[93] This is especially true where a business may be new.[94] The insured should not be penalized simply because ascertaining the precise loss is complicated.[95]

5. Place of Loss

A business interruption policy typically requires that the business interruption result from the destruction of, or damage to, listed property occurring at a specified location.[96]

Property that is clearly insured while at one location may be uninsured at another location.[97] Nevertheless, a change in the nature and extent of the operations covered by a business interruption policy will not affect coverage. Courts generally find that the purpose of the coverage is to insure against loss from interruption of the insured's business as a whole and refuse to restrict the recoverable loss to the exact operations or business in which the insured was engaged at the time the policy was issued.[98] For this reason, certain expansions of a business, so

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90 *General Insurance Co. v. Pathfinder Petroleum Co.*, 145 F.2d 368 (9th Cir. 1944) (applying California law); *Howard Stores Corp. v. Foremost Ins. Co.*, 82 App. Div. 2d 398, 441 N.Y.S.2d 674 (1981).

91 *Gregory v. Continental Ins. Co.*, 575 So. 2d 534 (Miss. 1990).

92 *Olympia Equipment Leasing Co. v. Western Union Tel. Co.*, 797 F.2d 37 (7th Cir. 1986).

93 *Cotton Bros. Baking Co. v. Industrial Risk Insurers*, 774 F.Supp. 1009 (W.D. La. 1989); *Ross v. Travelers Indem. Co.*, 325 A.2d 768 (Me. 1974).

94 *See Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*, 787 F.2d 349 (8th Cir. 1986); *Farmers Chemical Assoc. v. Maryland Casualty Co.*, 421 F.2d 319 (6th Cir. 1970).

95 *American Medical Imaging Corp. v. St. Paul Fire & Marine Ins. Co.*, 949 F.2d 690 (3rd Cir. 1991)(court rejected insurer's contention that income projections prepared by the insured's management for the upcoming year, based on the company's past performance and business situation at the time of the projections, were inadequate to create an issue of fact as to the extent of the business interruption loss sustained).

96 *Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co.*, 835 F.2d 812 (11th Cir. 1988); *Swedish Crucible Steel Co. v. Travelers Indem. Co.*, 387 F.Supp. 231 (E.D. Mich. 1974); *Gregory v. Continental Ins. Co.*, 575 So. 2d 534 (Miss. 1990); *Learfield Communications, Inc. v. Hartford Acci. & Indem. Co.*, 837 S.W.2d 299 (Mo. App. 1992).

97 *See, supra*, note 8.

98 *General Ins. Co. v. Pathfinder Petroleum Co.*, 145 F.2d 368 (9th Cir. 1944); *National Union Fire Ins. Co. v. Anderson-Prichard Oil Corp.*, 141 F.2d 443 (10th Cir. 1944).

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long as they do not radically change the nature of the business, will not operate to deny the insured coverage.[99] However, a sweeping change—making the business entirely different from that which was insured, might void the policy, on the theory that the parties did not contract with reference to the business resulting from the change.[100]

If a loss is suffered at a location not listed or described in the business interruption coverage, the loss may still be covered. Some jurisdictions hold that where the covered and non-covered locations are interrelated and interdependent, a business interruption at the non-covered location which results from physical damage or loss from an insured risk at the covered location falls within the scope of the policy.[101]

B. Exclusions

Policies commonly expressly exclude coverage for loss due to specified risks.[102] These exclusions will be strictly construed against the insurer.[103] When business interruption insurance is attached as an endorsement or rider to a property insurance policy, most courts have concluded that the exclusion of risks as to the property insurance did not apply to the business interruption coverage.[104]

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99 *Fidelity-Phoenix Fire Ins. Co. of New York v. Benedict Coal Corp.*, 64 F.2d 347 (4th Cir. 1933); *Great Northern Oil Co. v. St. Paul Fire & Marine Ins. Co.*, 303 Minn. 267, 227 N.W.2d 789 (1975)(expanded facility within the terms of the policy).

100 *Fidelity-Phoenix Fire Ins. Co. v. Benedict Coal Corp.*, 64 F.2d 347 (4th Cir. 1933).

101 *National Union Fire Ins. Co. v. Anderson-Prichard Oil Corp.*, 141 F.2d 443 (10th Cir. 1944); *Datatab, Inc. v. St. Paul Fire & Marine Ins. Co.*, 347 F.Supp. 36 (S.D. N.Y. 1972); *Learfield Communications, Inc. v. Hartford Acci. & Indem. Co.*, 837 S.W.2d 299 (Mo. App. 1992); *Wood Goods Galore, Inc. v. Reinsurance Ass'n of Minnesota*, 478 N.W.2d 205 (Minn. App. 1991). But see *Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co.*, 835 F.2d 812 (11th Cir. 1988)(loss of patronage at an insured hotel resulting from a fire on the noncovered premises of the insured's restaurant); *Howard Stores Corp. v. Foremost Ins. Co.*, 82 App. Div. 2d 398, 441 N.Y.S.2d 674 (1981).

102 *Diamond Shamrock Corp. v. Lumbermens Mut. Casualty Co.*, 466 F.2d 722 (7th Cir. 1972)(fire); *Cyclops Corp. v. Home Ins. Co.*, 352 F.Supp. 931 (W.D. Pa. 1973)(depletion, deterioration, corrosion, and wear and tear); *Peerless Dyeing Co. v. Industrial Risk Insurers*, 392 Pa. Super. 434, 573 A.2d 541 (1990)(water damage); *Pressman v. Aetna Casualty & Sur. Co.*, 574 A.2d 757 (R.I. 1990)(power failure); *Computer Works, Inc. v. CNA Ins Cos.*, 757 P.2d. 167 (Colo. App. 1988)(fraudulent scheme, trick, device, or false pretense); *Bartlett v. Continental Divide Ins. Co.*, 697 P.2d. 412 (Colo. App. 1984)(flood); *Rothenberg v. Liberty Mut. Ins. Co.*, 115 Ga. App. 26, 153 S.E.2d 447 (1967)(theft).

103 *See, supra*, note 21.

104 *Compagnie Des Bauxites de Guinee v. Insurance Co. of North America*, 794 F.2d 871 (3rd Cir. 1986); *Burdett Oxygen Co. v. Employers Surplus Lines Ins. Co.*, 419 F.2d 247 (6th Cir. 1969); *Kilroy Industries v. United Pacific Ins. Co.*, 608 F.Supp. 847 (C.D. Cal. 1985); *Pressman v. Aetna Casualty & Sur. Co.*, 574 A.2d 757 (R.I. 1990). But *see Peerless Dyeing Co. v. Industrial Risk Insurers*, 392 Pa. Super. 434, 573 A.2d 541 (1990).

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Business interruption insurance does not cover losses for which the insured has been reimbursed through property insurance.[105] Also, one court has held that it does not protect against a drop in value of corporate stock due to a fire and resultant loss.[106]

C. Contingent Business Interruption Coverage

Policyholders can extend their business interruption coverage to insure loss resulting from business interruption caused by damage or destruction of real or personal property at "dependent properties"—namely, the properties of those businesses upon which the insured's income is greatly dependent, such as those who supply the insured's materials, purchase the insured's goods, or attract customers to the insured's business. This is called contingent business interruption coverage.

What most commonly constitutes "dependent properties" are the insured's suppliers' real or personal property and its customers' real or personal properties. Damage to an insured's suppliers'[107] or customers' properties can disrupt the flow of services and result in monetary losses to the insured because either the insured does not have the goods to deliver to its customers (due to damage or loss to the "contributing location") or else the insured cannot deliver the goods to its customer due to damage or destruction to the customer's premises (the "recipient location").[108]

Contingent business interruption insurance will pay for losses of business income due to the necessary suspension of the insured's operations during the "period of restoration." The period of restoration begins 72 hours after the direct physical loss caused by a covered peril to the dependent property premises and ends on the date when such property should be repaired, rebuilt, or replaced "with reasonable speed and similar quality."[109] Incidentally, operations at the dependent property site need not be shut down entirely for the insured to obtain coverage; all that is necessary is that a covered peril occur at the dependent property and the insured's business is interrupted because of it.[110]

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[105] *Fireman's Fund Ins. Co. v. Mitchell-Peterson, Inc.*, 63 Ohio App. 3d 319, 578 N.E.2d 851 (1989); *Rothenberg v. Liberty Mut. Ins. Co.*, 115 Ga. App. 26, 153 S.E.2d 447 (1967);.

[106] *Unijax, Inc. v. Factory Ins. Ass'n*, 328 So. 2d 448 (Fla. Dist. Ct. App. 1976).

[107] Depending on the language, a "supplier" is an unrestricted group of those who furnish what is needed or desired. See *Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of New York*, 975 F.Supp. 1124 (S.D. Ill. 1997) (finding U.S. Coast Guard and Army Corps of Engineers, who designed and developed systems for navigation of the river constituted "any suppliers of goods and services" to insured farmers).

[108] Paula B. Tarr, *Where Have All The Customers Gone?: Business Interruption Coverage For Off-Premises Events*, 30 The Brief 20, 28 (2001).

[109] *Id*.

[110] *Id*.

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IV. CONCLUSION

Business interruption insurance is becoming an increasingly vital tool for all businesses, big and small. Businesses should carefully choose which premises they insure, if they do not insure all; whether the policy is valued or open; what risks are excluded if choosing a named perils policy; how the policy defines lost earnings and whether such a definition will maximize recovery in the event of a loss. Policyholders should also consider whether acquiring contingent business interruption coverage is a prudent course of action.

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