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ARTICLES

Proper Recovery of "Compelled" Costs of Response under CERCLA

By M. Camila Tobon

When the U.S. Supreme Court decided *United States v. Atlantic Research Corp.*, 551 U.S. 128 (2007), the Court settled a long-standing judicial debate over when potentially responsible parties (PRPs) under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. § 9601, *et seq.*, could pursue other PRPs for “cost recovery” instead of “contribution.” The Court concluded that parties that had voluntarily incurred response costs in cleaning up hazardous substance contamination could pursue other PRPs through a “cost recovery” action under section 107 of the statute. But parties that had reimbursed response costs through satisfying a settlement agreement or court judgment could only bring a claim against other PRPs for “contribution” under section 113 of the statute.

But what about “compelled” costs of response that are neither incurred voluntarily nor incurred by reimbursing another party? The Supreme Court declined to decide this question in *Atlantic Research*, leaving open whether parties that had settled their liability under sections 106 or 107 through a consent agreement, and thus incurred costs pursuant to the consent agreement, could recover from other potentially responsible parties under section 107, or section 113, or both. As the Court stated, “[i]n such a case, the PRP does not incur costs voluntarily but does not reimburse the costs of another party.”

Recently, in *Morrison Enterprises, LLC v. Dravo Corp.*, 638 F.3d 594 (8th Cir. Neb. 2011), the Eighth Circuit answered the question left open by *Atlantic Research*, concluding that Morrison Enterprises and the City of Hastings, Nebraska, could not sue Dravo Corp. for cost recovery under section 107 because they had previously settled their liability under sections 106 and 107 through a series of agreements on consent (AOC) and consent decrees (CD) and, thus, were not incurring costs voluntarily to remediate groundwater contamination at the Hastings Ground Water Contamination Superfund Site. Because contribution under section 113 was the exclusive remedy available to Morrison and Hastings, summary judgment granted in favor of Dravo was affirmed.

Background

The facts of the case are as follows. In 1986, the area where the City of Hastings’s drinking-water wells are located was designated as the Hastings Ground Water Contamination Superfund Site due to the presence of contaminants including ethylene dibromide (EDB), carbon tetrachloride (CT), and other volatile organic compounds (VOCs). The contamination at the site was determined to be originating from seven source areas, three of which were the focus of litigation between the plaintiffs, Morrison and Hastings, and defendant Dravo.

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The first source area was the FAR-MAR-CO subsite, where Morrison was identified by the Environmental Protection Agency (EPA) as a potentially liable party for the release of hazardous substances. Morrison settled its potential liability for the FAR-MAR-CO site in a 1991 AOC, a 1996 AOC, and a 2008 CD. Both the 1996 AOC and 2008 CD obligated Morrison to operate a treatment system, referred to as “Well-D,” to remove trichloroethylene (TCE), EDB, and CT from the groundwater.

The second was the Colorado Avenue subsite, where Dravo was identified by the EPA as a potentially liable party for the release of TCE. Dravo entered into a 2006 CD with the EPA for the remediation of TCE at the Colorado Avenue subsite.

The third was the North Landfill subsite, where the EPA identified Hastings and Dravo as PRPs. Hastings entered into a 1992 AOC addressing its liability for the North Landfill subsite. Both Hastings and Dravo then entered into a 1998 CD to perform a source-control remedy, and then a 2007 CD for the operation of Well-D and containment of the migration of VOCs from the North Landfill subsite.

In Court

In 2008, Morrison and Hastings sued Dravo, seeking, *inter alia*, cost recovery pursuant to CERCLA section 107 and a declaratory judgment of Dravo’s liability for future response costs under CERCLA section 113(g)(2). The plaintiffs did not seek contribution from Dravo pursuant to section 113(f) of CERCLA. Dravo raised, as an affirmative defense, the argument that the plaintiffs were entitled only to a claim for contribution under section 113(f); the plaintiffs’ motion to strike this affirmative defense was denied. A subsequent amended complaint did not include a CERCLA contribution claim, and Dravo’s amended answer raised the same affirmative defense.

Dravo first moved for summary judgment on Hastings’s water-supply-system claim, arguing that the statute of limitations barred the claim. The district court agreed, based on a finding that Hastings’s replacement of its water system constituted a remedial action rather than a removal action under CERCLA, for which the statute of limitations had lapsed. The Eighth Circuit affirmed on this point.

Dravo also moved for summary judgment on Morrison and Hastings’s Well-D claims, arguing that the plaintiffs could not pursue a cost-recovery action under CERCLA section 107. The district court granted Dravo’s motion in part, finding that CERCLA section 113(f) provided the plaintiffs’ exclusive remedy. Morrison then filed a motion for leave to amend its complaint to assert a section 113 contribution claim that was denied. The plaintiffs appealed the district court’s summary judgment rulings as to their CERCLA liability claims, and Morrison appealed the district court’s denial of its motion for leave to amend the complaint.

In answering the question whether the proper claim against Dravo by Morrison and Hastings was under section 107 or section 113, the Eighth Circuit analyzed two arguments. First, that Morrison and Hastings could sue under section 107 because they “voluntarily” incurred costs for remediating the TCE through operation of the Well-D system. Second, that Morrison and Hastings could not sue in contribution under section 113 because there was no common liability between the parties because in Morrison’s case, responsibility was for releases of entirely different wastes and, in Hastings’s case, Dravo was the sole party responsible for releases at the Colorado Avenue subsite.

The Eighth Circuit rejected the first argument, that the plaintiffs “voluntarily” incurred costs for remediating the TCE through operation of the Well-D system. With regard to Morrison, the court of appeals held that the 1996 AOC specifically obligated Morrison to operate Well-D to remove TCE from the groundwater as a liable party under section 107. The court of appeals stated that Morrison’s reading of *Atlantic Research*—that “voluntarily” refers to actions taken “without any establishment of liability to a third party, such as through a judgment or court order”—was incorrect. Unlike the plaintiff in *Atlantic Research*, Morrison had been sued under sections 106 and 107 and entered in administrative settlements to resolve its liability. Furthermore, the 1996 AOC specifically obligated Morrison to operate Well-D to remove TCE from contaminated groundwater as a “liable party.” Thus, the court of appeals concluded, Morrison was not incurring costs voluntarily.

With regard to Hastings, the court of appeals found that Hastings was obligated, as a liable party, to perform certain remedial actions at the site by the 1992 AOC and to address liability for migrating TCE by the 1998 CD and 2004 AOC. Further, by Hastings’s own account, it was obligated to continue operation of Well-D to contain migration of the TCE plume. The court of appeals thus concluded that Hastings had not operated Well-D voluntarily.

Hastings also argued that the district court’s focus on Well-D was too narrow. Instead, the focus should be on Dravo’s liability for contamination from the Colorado Avenue subsite. Because Hastings’s settlement of liability at the North Landfill subsite was separate from Dravo’s liability at the Colorado Avenue subsite, Hastings argued, its operation and maintenance of Well-D to clean up contamination from the latter was voluntary. The Eighth Circuit disagreed, noting that under CERCLA, once a party is liable under section 107(a), it is liable for its share of any and all response costs, not just the costs “caused” by its release. As a result, the court of appeals affirmed the district court’s conclusion that Hastings must use contribution under section 113 to allocate responsibility for operating Well-D to remove accumulating TCE because Hastings and Dravo are both responsible for the release of TCE into the city’s groundwater and because TCE contamination from the North Landfill and Colorado Avenue subsites had migrated to the FAR-MAR-CO subsite.

Turning to the “common liability” argument, the Eighth Circuit held that the shared liability between Morrison, Hastings, and Dravo for contaminating the groundwater and for operating

Well-D to remove those contaminants was sufficient to support a claim for contribution under CERCLA. Morrison argued that it did not share common liability with Dravo because it was never subject to liability under section 107 for response costs necessary to address TCE from the Colorado Avenue subsite, or anywhere else. Similarly, Hastings argued that because it was not liable for hazardous-substances releases at the Colorado Avenue subsite, it did not have a right to contribution. Hastings also challenged the district court's focus on Well-D, arguing that common liability arises from conduct leading to an indivisible harm and not from a single solution to multiple, divisible harms.

The court of appeals disagreed that the scope of liability suggested by the plaintiffs was that which was contemplated by CERCLA. First, the focus of CERCLA is on whether the defendant's release or threatened release caused harm to the plaintiff in the form of response costs. Second, when multiple parties are liable for response costs, the focus turns to allocation of each party's respective responsibility, which is determined through a contribution claim under section 113. The Eighth Circuit agreed with the United States, as *amicus curiae*, that because Well-D removes hazardous substances for which Morrison, Hastings, and Dravo are each responsible, they are jointly and severally liable for the response costs to operate it. The court of appeals also noted that Morrison, Hastings, and Dravo were each liable through various consent agreements to remediate TCE by operating Well-D. This shared liability was therefore sufficient to support a section 113 contribution claim, the court of appeals concluded.

On Morrison's appeal of the district court's denial of its motion for leave to amend the complaint to add a section 113 contribution action, the Eighth Circuit affirmed. The court of appeals agreed that Morrison had ample notice from Dravo's answer and response to Morrison's motion to strike its affirmative defense that Dravo contended that contribution under section 113 was Morrison's exclusive remedy and found no abuse of discretion in the denial of the motion for leave to amend.

Conclusion

Following its decision in *Morrison*, the Eighth Circuit now joins the Second and Third Circuits in answering the question left open in *Atlantic Research*, concluding that, where multiple parties are involved, section 113(f) of CERCLA provides the exclusive remedy for a liable party compelled to incur response costs pursuant to an administrative or a judicially approved settlement under CERCLA sections 106 and 107. See *Niagara Mohawk Power Corp. v. Chevron USA*, 596 F.3d 112, 124 (2d Cir. 2010); *Agere Sys., Inc. v. Advanced Env'tl. Tech. Corp.*, 602 F.3d 204 (3d Cir. 2010). However, the issue is not settled as lower courts are still working through arguments on both sides. When litigating outside the Second, Third, and Eighth Circuits, the plaintiffs' interests in seeking to recover compelled costs of response would be best protected by asserting both a section 107 cost-recovery claim and a section 113 contribution claim until such time as other circuits have the opportunity to address this issue or until such time as the Supreme Court answers the question it left open in *Atlantic Research*.



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Keywords: environmental litigation, Atlantic Research, Morrison, Hastings, EDB, CT, TCE, Dravo, FAR-MAR-CO

Value Assurance Programs: A Case Study in the Model City

By Christina M. McLean and Jerry M. Dent II

“Anniston—a remarkable iron-producing, textile-manufacturing, industrial town born in the difficult Reconstruction days and which came to be known far and wide as the ‘Model City’”

“It was a paradigm, the best . . .”

“Anniston still bears the stamp of the careful planning of its founders.”

— Preface to *The Model City of the New South, Anniston, Alabama, 1872–1900*, by Grace Hooten Gates

Roots of the Model City

Founded in 1872 as a private company town, funded by northern investors and fueled by the dreams and ambitions of Samuel Noble and Daniel Tyler, Anniston soon earned its nickname as the “Model City.” From the beginning, the city was designed for industry and the work force that accompanied it. The abundant iron ore in the region drove industry. Much thought and planning was given to community design. Social, religious, and educational institutions thrived, and the town flourished. See *The Model City of the New South, Anniston, Alabama, 1872–1900*, by Grace Hooten Gates, 1978.

Modern Anniston

Industry continued to boom in Anniston through the first part of the twentieth century, but unfortunately the explosive industrial growth could not be sustained. According to historian Gary Sprayberry,

By the 1980s and 1990s, however, a stagnant economy, a lack of commercial and industrial diversification, the impending closure of Fort McClellan, PCB contamination from the local Monsanto (now Solutia) plant, and the proposed construction of a chemical weapons incinerator at the Anniston Army Depot had left the Model City’s economic future in doubt. Many of the factories and mills that had employed thousands and gained the city a reputation for progress and efficiency, such as the Anniston Cordage Company, had been shut down or gutted. A market shift to plastic piping in the 1970s and a general decline in the heavy-metal and concrete industries, as foreign firms became more competitive, further damaged Anniston’s economy. By 1993, unemployment rates in the city had inched above 17 percent (Calhoun County’s unemployment rate stood at 9 percent). Seven years later, according to the 2000 federal census, the median family income

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in Anniston stood at \$36,067, far below the national average of \$50,046. More than 20 percent of the city's residents lived below the poverty level.

See Gary Sprayberry, [History of Anniston](#), Columbus State University (updated as of Mar. 8, 2011).

The results of Anniston's industrial past have led to "significant contamination problems" according to the U.S. Environmental Protection Agency (EPA) (U.S. EPA Fact Sheet, Anniston PCB Site, Anniston, Calhoun County, Alabama, August 2002), a multitude of lawsuits, (e.g., see Dennis Love, *My City Was Gone: One American Town's Toxic Secret, Its Angry Band of Locals, and a \$700 Million Day in Court*, 2006), and extensive negative national press (e.g., see *60 Minutes: Toxic Town* (CBS television broadcast November 2002), making this a unique environment for any corporate entity defending property-value-diminution claims in Anniston.

History of McWane, Inc.

The origins of McWane, Inc. can be traced back to Charles Phillip McWane, who entered the foundry business in 1871. Through multiple generations and growing through acquisitions and innovations, [McWane](#) has transformed from "a modest foundry enterprise" in 1903 to an international operation today with "[four pipe facilities, four valve and hydrant facilities, seven soil pipe and utility fittings facilities, seven tank manufacturing facilities and one fire extinguisher facility.](#)"

Two of the company's [acquisitions](#) were located in Anniston. The Union Foundry Company, which produced waterworks fittings, was purchased in 1977. A second plant, M&H Valve Company, was purchased in 1984, allowing the company to diversify into waterworks valves and fire hydrants.

Overview of the *Almon* Matter

The first amended class-action complaint in the matter of *Charlie Almon, et al. v. McWane, Inc., et al.* was filed in December 2004 in the circuit court of Calhoun County, Alabama. In it, the plaintiffs alleged that McWane, through its ownership and operation of M&H Valve and Union Foundry, caused their properties to be contaminated and their property values to be diminished. Specifically, the complaint alleges:

- Foundry sand (a natural by-product of the foundry operations) containing contaminants such as PCB (polychlorinated biphenyl), lead, cadmium, zinc, chromium, and arsenic, among others, was given away or sold for residential or commercial fill with no indication it was contaminated.
- Contaminated wastewater was discharged into local sewer systems, creeks, and other waterways.
- Regular emissions were discharged into the air-containing lead, soot, foundry sand, particulates, and other contaminants.



The proposed class definition included “all property owners, lessees, and licensees of properties on which the defendants’ deposited waste substances, including soot, soil, dust, foundry sand, fluff, PCBs, lead, cadmium, zinc, chromium, arsenic, or other hazardous substances or waste materials, and/or engaged in conduct or practices that allowed such substances and materials to migrate to and/or become located on plaintiffs’ property; . . .” The plaintiffs sought injunctive relief, punitive damages, and compensatory damages, along with all other damages to which they may be entitled under Alabama law.

Settlement Overview

The settlement agreement included a value assurance program (VAP) to address property value concerns and allowed a satisfactory compromise to be reached. The final settlement agreement included multiple components:

- injunctive benefits
- administrative benefits
- cash component
- value assurance program

The settlement components are described in more detail below.

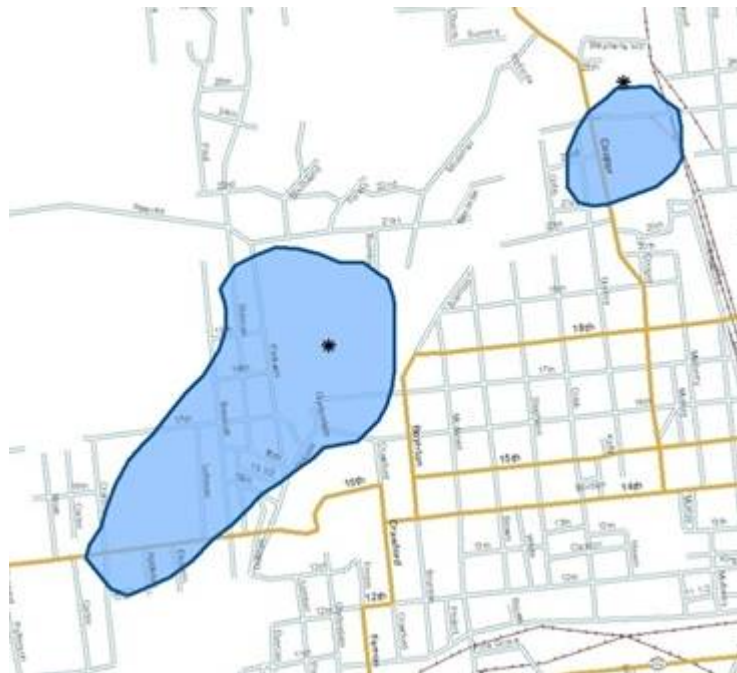
The final judgment and order approving settlement and dismissing claims in the *Almon* matter was entered on March 4, 2010. A preliminary order had been issued in November 2009. Subsequent to the preliminary order being filed and notice being given, owners of only about one-fifth of one percent of the more than 64,000 potential parcels of the settlement class chose to opt out of the proposed settlement.

In the final order, Judge Joel Laird wrote that

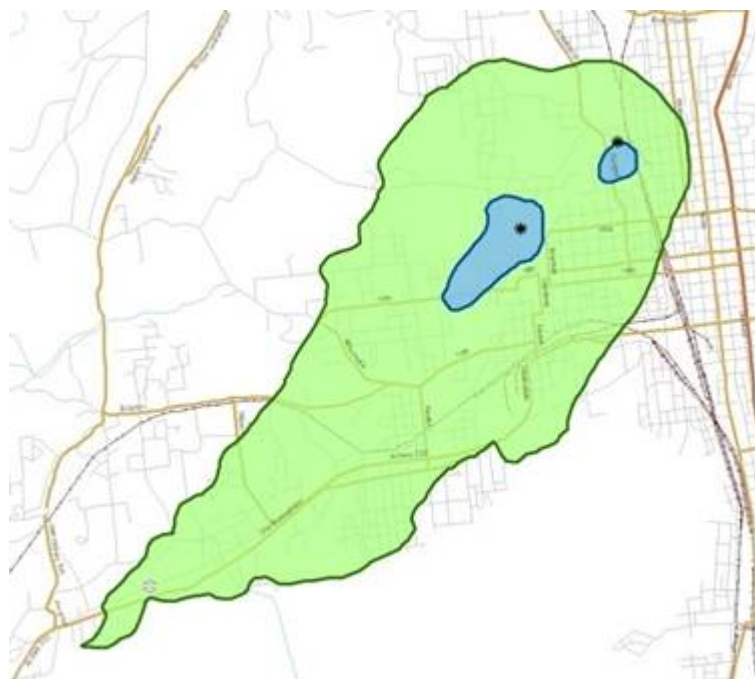
(i) the Settlement provides significant financial benefits to Settlement Class Members; (ii) there is no evidence suggesting that the Settlement was the result of anything other than good-faith arms-length negotiations; (iii) counsel for the Settlement Class conducted a reasonable and thorough investigation of the facts and law relating to the claims asserted by Settlement Class Members . . .; and (iv) counsel for the Settlement Class are experienced in class action litigation . . . the terms of the settlement . . . are in all respects fair, just, reasonable, and adequate and in the best interests of the plaintiffs and to the Settlement Class.

Through settlement negotiations, three settlement zones were ultimately agreed upon.

- **Settlement Zone A:** residential property located nearest Union Foundry and M&H Valve, excluding the properties that were the subject of a prior settlement (the *Baker* settlement class)



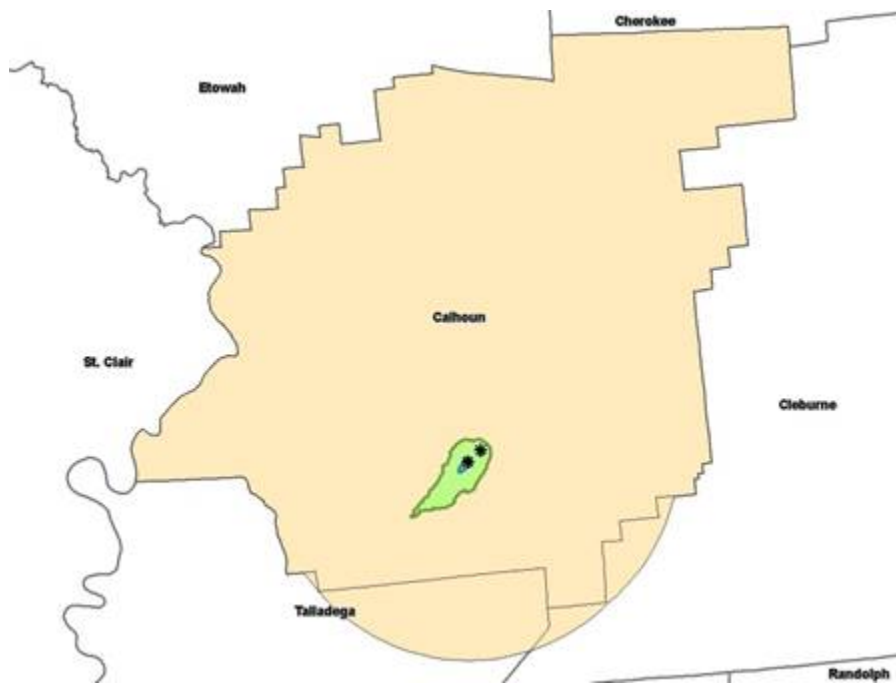
- **Settlement Zone B:** residential property located from the boundary of Settlement Zone A in all directions to the boundary shown on the map, excluding the properties that were the subject of the *Baker* settlement class



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- **Settlement Zone C:** residential property located from the boundary of Settlement Zone B in all directions to the boundary shown on the map. This includes all of Calhoun County, Alabama, and portions of Talladega and Cleburne Counties.



Injunctive Benefits

McWane agreed to no less than \$1 million in site improvements at Union Foundry and M&H Valve to be performed within two years of the effective date of the settlement.

Administrative Benefits

Other than specific exceptions related to the VAP described below, McWane agreed to be responsible for all expenses related to class notice and administration of the settlement, including the costs of the settlement administrator.

Cash Component

McWane agreed to pay \$4.2 million into a fund to be distributed by the settlement administrator in its entirety. The funds must be used to pay incentive rewards to the class representatives, cash claims made by eligible class members, and attorney fees and expenses. Any remainder will be distributed to a charity or program agreed upon by all parties and approved by the court.



Value Assurance Program

A VAP is a contract between the VAP sponsor (in this instance, McWane) and eligible participants. Although nearly all aspects of a VAP are flexible and can be customized for a particular site and/or issue, at its core every VAP is a promise to compensate eligible participants if their property should sell for less than market value during a specified time frame.

A VAP can be a powerful stabilizing force in a residential real-estate market that is skittish due to real *or* perceived environmental issues. It calms homeowner fears by protecting the value of what is likely their most valuable asset. It preserves property values and provides liquidity to the market. A VAP builds public trust and opens a line of communication between the sponsor and the community. For the sponsor, a VAP spreads settlement dollars to a larger potential pool of recipients. In a traditional settlement, a payment may be made to every person irrespective of actual documented damage. In a VAP, while the protection is available to every eligible participant, compensation only occurs when damage is actually documented.

As mentioned previously, every aspect of a VAP is customizable (and therefore negotiable as a tool for reaching settlement):

- **Structure:** time-frame, sub-classes, right of first refusal, required documentation, etc.
- **Eligibility:** geography, property types, owners, test results, etc.
- **Incentives:** real-estate-agent commissions, home-improvement grants, etc.
- **Provisions:** mortgage subsidies, relocation expense reimbursement, environmental insurance policies, etc.

Almon VAP

Program Eligibility and Definitions

As part of the final settlement, the VAP is a completely voluntary program and is available to current owners as of November 23, 2009, of eligible residential property within the settlement zones.

The VAP is not an offer to purchase property but rather is a means of compensating eligible property owners in the event their property sells for less than fair market value (FMV).

Eligibility for the VAP is determined as follows:

- Property must be within one of the defined program areas (i.e., the three settlement zones).
- Property must be residential property.
- Property must meet all testing and other requirements as defined in the VAP booklet.
- Property must be owned by an individual and not as part of a business.
- Sale must occur between April 26, 2010, and April 26, 2013.



Environmental Litigation

FROM THE SECTION OF LITIGATION ENVIRONMENTAL LITIGATION COMMITTEE

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In addition, property owners who choose to sell must follow the criteria below:

- Property must be listed with an approved real-estate agent.
- Reasonable efforts to obtain the maximum sale price must be made.
- Claim to the VAP must be made within 30 days of closing.

Each of the eligibility criteria and key terms are defined in greater detail in the VAP booklet that was made available to all eligible property owners.

Fair market value is a fundamental concept to the structure of the VAP. As such, it is clearly defined in the VAP booklet as follows:

Fair Market Value is what your property is worth at the time of sale, absent the influence of any real or perceived environmental issues. To determine the value of your property, the VAP Administrator will use established appraisal techniques such as the market-based approach, historical appreciation rates, statistical modeling and/or adjusted assessed values.

Reasonable efforts are also a key component of the VAP. Reasonable efforts were thus defined to include:

- You must list the property with one of the approved real-estate agents. These are agents fully licensed to sell residential property, who are familiar with your neighborhood and who have agreed to participate in the VAP.
- You must make diligent efforts to comply with the reasonable suggestions of your approved real-estate agent, including listing the property at the appropriate price, making reasonable improvements to your property not to exceed \$1,000, advertising your property, and showing your property.
- The transaction must be arm's length. This means that if you sell your property to a related party, such as a friend or a relative, for less than fair market value, you are not eligible to participate in the VAP.

Program participation varies based on the settlement zone in which a property is located. The following matrix identifies the basic requirements and benefits for each zone, which are discussed in greater detail below.

Table 1: Basic Requirements for VAP Participation

Settlement Zone	Qualified Analytical Data	Proof of McWane Foundry Sand
A	Not Required	Not Required
B	Required	Optional
C	Required	Required

Table 2: VAP Restitution Percentage by Zone and Requirement

Settlement Zone	Qualified Analytical Data	Proof of McWane Foundry Sand	Restitution Percentage
A	NA	NA	25%
B	Yes	Yes	100%
B	Yes	No	75%
B	No	No	0%
C	Yes	Yes	100%
C	Yes	No	0%
C	No	No	0%

Qualified Analytical Data

Properties in Settlement Zones B and C are only eligible for the VAP if they have qualified analytical data. To meet the condition of “qualified analytical data,” sampling must be performed by an approved environmental firm (defined within the VAP booklet) and soil results must meet one of the agreed-upon thresholds: 1) Lead must be 350 ppm or higher, or 2) cadmium must be 3.7 ppm or higher and chromium must be 10,000 ppm or higher.

If sampling was not performed previously by class counsel’s consultant, certain procedures must be followed by the VAP participant to retain eligibility. Specifically, the property owner must submit

- new qualified analytical data request form (found in the VAP booklet)
- access-for-testing form signed by the new owner (because the property will have been sold at this point) for the sampling and analysis to be performed
- \$250 advance payment toward the cost of the sampling and analysis

Proof of McWane Foundry Sand

In addition, members of Settlement Zone C must provide documentation of the receipt of foundry sand from Union Foundry or M&H Valve during McWane’s period of ownership (1977 to present and 1984 to present, respectively) to be eligible for benefits under the VAP. Members of Settlement Zone B, at their discretion, may choose to submit such documentation to receive a greater benefit from the VAP than they would otherwise be eligible.

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To prove receipt of foundry sand, the claimant must provide evidence that 1) the person received foundry sand during the specific periods named and 2) the foundry sand originated from a McWane facility. An independent special master will evaluate these claims, either through written documentation, sworn oral testimony, or both, that a property was the recipient of foundry sand from one of the McWane plants during the period of ownership and operation.

The VAP participant must do the following to preserve eligibility:

- Confirm in writing the desire to submit proof of McWane Foundry sand.
- Submit documentation, if any, of receipt of foundry sand from Union Foundry or M&H value.
- Submit \$250 toward the cost of the process (special master).

Proof of McWane Foundry Sand will be deemed to exist if one of the following is met:

- documentation, such as a bill of lading, manifest, receipt of payment, or similar, showing receipt of foundry sand from Union Foundry or M&H Valve during McWane's period of ownership and operation, or
- testimony by the claimant and one additional person unrelated to the claimant, submitted under oath (and possibly recorded by a court reporter), based on personal knowledge, and subject to the penalty of perjury, before the designated special master confirming the delivery of foundry sand to the property from Union Foundry or M&H Valve during McWane's period of ownership and operation. The testimony cannot be hearsay.

VAP Process

Although the requirements vary widely, the basic process for participants in each settlement zone is similar. When the property owner is ready to sell, he or she must list the property with an approved real-estate agent. These agents have been selected as those active and familiar with the area, have received training regarding the VAP and its requirements, and are willing and able to guide participants through the process. The property owner must then follow the agent's suggestions and make reasonable efforts to sell the property for the highest amount possible.

When a written offer is received that the property owner desires to accept, the required form is completed and submitted to the VAP administrator. At that time, McWane will have 48 hours to decide if it would like to purchase the property. McWane, if it chooses to purchase, will pay the offer price or FMV, whichever is greater. If McWane chooses not to purchase, the offer may be accepted, and closing occurs in a typical fashion.

After closing, and assuming McWane does not purchase the property, the seller (i.e., the former property owner) may choose to make a claim to the VAP if he or she feels as though the sale price received was less than the FMV. Once a claim form is received, the VAP administrator will establish the FMV of the property and compare to sale price.



The remainder of the claims process varies by settlement zone:

Settlement Zone A. No other action is required by the claimant. If FMV is greater than sale price, the seller will be compensated for the difference multiplied by the appropriate restitution percentage. If sale price is greater than FMV, no payment is due from the VAP.

Settlement Zone B. The claimant must also provide qualified analytical data as discussed above. If qualified analytical data is provided, and if FMV is greater than sale price, the seller will be compensated for the difference multiplied by the appropriate restitution percentage (in this case, 7.5 percent). However, at his or her discretion, the claimant may also provide proof of McWane Foundry sand as discussed above. If Proof of McWane Foundry sand is also provided, and FMV is greater than sale price, the seller will be compensated for 100 percent of the difference. If sale price is greater than FMV, or if the property does not have qualified analytical data, no payment will be made from the VAP and proof of McWane Foundry sand is irrelevant.

Settlement Zone C. The claimant must provide both qualified analytical data and proof of McWane Foundry sand. If this requirement is not met, no payment is due from the VAP. If sale price is greater than FMV, no payment is due from the VAP. However, if both criteria are met and sale price is less than FMV, the seller will be compensated for 100 percent of the difference.

Conclusion

Absent health claims, property owners are primarily concerned with protecting the value of their most important (and typically most valuable) asset—their home. A VAP is a direct means to address fears of property-value diminution. Analysis of former VAPs has illustrated the stability a VAP provides to the real-estate market by returning time on market, average sale price, and other real-estate metrics to pre-VAP conditions. The *Almon* settlement is an excellent example of a creative approach where property owners benefit because they will be compensated should they sell at less than FMV and McWane will benefit because only property owners truly damaged will receive benefits. In the end, all stakeholders benefit from the VAP as the economics of the market return to ordinary supply-and-demand conditions.

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Keywords: environmental litigation, model city, VAP, Anniston, McWane, Almon

The Bermuda Form, Environmental Pollution, and Property-Damage Claims

By Julian Miller, Stephen Turner, and Jeffrey M. Pollock

This article discusses the key features of the Bermuda Form insurance policy. These are considered both generally and in the context of claims for property damage. The form may be important in certain environmental cases where insurance coverage is in play. In short, the Bermuda Form is an excess-liability cover that arose in response to the collapse of the U.S. excess-liability market in the 1980s. Typically, it is an umbrella policy, written in broad terms.

There is no single standard version of the Bermuda Form, although certain clauses or concepts are adopted widely. As with most insurance policies, the policy requirements, coverage, and exclusions must be carefully examined to determine whether the identified risk of the insured is appropriately covered. For example, the notification requirements are unusually complex and warrant careful attention. For property-damage claims, the application of the exclusion clauses is central to understanding how the policy applies.

Key Concepts

- occurrence reported
- aggregation and integrated occurrence
- notice of occurrence and integrated occurrence
- “expected or intended” liabilities excluded
- “discovery period” cover is available
- modified New York law with London or Bermuda arbitration

Occurrence and Occurrence Reported

An important feature of the Bermuda Form is that it is an “occurrence reported” policy. There must be an occurrence and a report of the occurrence during the period of the policy. An occurrence, for personal injury and property damage, means either that (a) damage or injury is caused by the insured’s product within the policy period, or (b) where the insured’s product is not the cause of the damage or injury, that there is either an event or a continuous exposure to conditions, which commences in the policy period. Both definitions of occurrence can be important in the context of an environmental problem because the liability of the insured could arise either from its products or from its manufacturing site.

Unusually, the Bermuda Form’s coverage does not always cease at the end of each policy year, although there are new premiums and limits of liability for each annual period. If there were an occurrence in year one that is reported to the insurer in year two, then (all things being equal)

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this would be covered by the policy. As will be seen below, if covered, it would be policy limits for year two, which would be engaged.

If two or more injuries or incidents of property damage occur within 30 days of one another as a result of a common event or cause, then these are aggregated and treated as a single occurrence. Injuries or property damage commencing more than 30 days apart are not “batched” under the automatic aggregation provision. However, if injuries or damage can be batched in more than one way, then it appears that it is for the policyholder to choose the batching most favorable to him or her. This treatment is automatic under the Bermuda Form. Only one year’s policy will ever respond to an occurrence that is aggregated in this way.

Integrated Occurrence

Where personal injuries or property damage to two or more persons or properties have a common cause or there is a common defect, but they commence more than 30 days apart, then their treatment as a single occurrence depends upon whether the insured elects to give notice of an integrated occurrence.

This is a key concept within the Bermuda Form. It allows for (but does not require) the aggregation of occurrences that occur over time, including in different policy years, to be aggregated and applied against a single-policy deductible. Because the Bermuda Form is an excess-liability policy, this provision is often essential to the insured because it allows the batching of smaller claims to erode the excess and to engage coverage. From an insurer’s perspective, if the insured elects to give notice of an integrated occurrence, then it prevents multiple policies being exposed to the same cause of injury or property damage. The same “risk” is only insured under one policy year.

Notice of Occurrence and Integrated Occurrence

There are prescribed requirements for giving notice, which must be adhered to. As would be expected, notice of an occurrence must be given as soon as is practicable after an officer of the insured becomes aware that an occurrence is likely to “involve” the policy. The time notice is given fixes the policy period in which the policy will respond. There are additional criteria for giving notice in the case of some liabilities caused by pollution that will be discussed below when we consider how the Bermuda Form responds specifically to claims for environmental damage.

If the insured wishes to designate two or more injuries from a common cause occurring more than 30 days apart as an “integrated occurrence,” then specific notice to this effect must be given, in the specified form. Where notice of integrated occurrence is given, this fixes the policy year in which the policy will respond to all past, present, and future liabilities arising from the common cause or defect that will be “integrated” into that policy year. That remains true, even if the policy limits are subsequently reduced or the policy canceled in a year after notice of integrated occurrence being given.



Expected or Intended

The Bermuda Form is designed to cover catastrophic losses. It does not cover “expected or intended” liabilities. This is sometimes known as the “maintenance deductible,” a phrase not used in the Bermuda Form itself, but used by some practitioners.

In the case of integrated occurrences, the Bermuda Form typically excludes from cover both the “expected or intended” level or rate of personal injury and property damage, and the level or rate “historically experienced.” This shows exactly what the Bermuda Form is designed to do: cover catastrophic losses where the damage is different or at a level or rate vastly greater in magnitude than anticipated or intended. This has obvious relevance where a company knows that its manufacturing processes will inevitably cause a certain level of environmental contamination.

Discovery Period Cover

The policyholder is often given the opportunity to purchase cover for occurrences within the policy period but which are not yet reported. This allows notification after the termination of coverage for injuries or damage that occurred while cover was in force. This cover can significantly enhance the utility of the insurance and should be considered by insureds when ending their ongoing cover with a Bermuda Form insurer, or renewing on different terms.

London Arbitration, Modified New York Law

Disputes arising under the Bermuda Form are generally resolved by arbitration in London by arbitrators selected by the parties.

London arbitration has the benefit of being confidential, and the process is strongly supported by the English Arbitration Act 1996. Appeals to the courts are rare. They may only be made on limited grounds, error of law in New York not generally being among them. The deposition procedure is not used, and witness statements are prepared and generally stand as evidence-in-chief. Thus, a witness’s first encounter with the tribunal will be when facing cross-examination by counsel for the opposing party.

The Bermuda Form prescribes a form of modified New York law, modified so as to treat the parties in an even-handed way. This is sometimes referred to as “New York law minus.” In particular, it does not allow for the payment of punitive damages and precludes the interpretation of the form in a way that is adverse to the insurer (as author). It also prohibits parol evidence (including the evidence of negotiations regarding the policy) as evidence of what the policy means. It may be possible to adduce extrinsic evidence if it goes to the commercial context, or “factual matrix,” but disputes about admissibility can arise.

Environmental Damage: Specific Considerations

Cover for liabilities under the Bermuda Form arising out of environmental problems is restricted by exclusions in the policy wording. There are at least four exclusions of which any corporation considering the Bermuda Form to guard against environmental risks should be aware:

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- owned-property exclusion
- pollution exclusion
- toxic-substances exclusion
- nuclear exclusion

The Owned-Property Exclusion

The Bermuda Form severely restricts cover for damage to a corporation's own property. Specifically, there is an exclusion for property damage to any property owned, occupied, rented, loaned, or in the care, custody, or control of any insured. There is a further exclusion for damage to real property arising out of the operations of any insured or its contractors or subcontractors.

A Bermuda Form policy provides third-party liability cover, so the broadly worded exclusion for first-party property damage should be expected. Corporations routinely purchase property insurance at a high level to protect against fire, extreme weather, or flooding destroying their manufacturing plants or research centers. Insureds should, therefore, check that any damage that they cause to their own plants through environmental spills (for example) are covered under their first-party property policies rather than looking to any cover they have purchased governed by the Bermuda Form.

There remains some important cover provided by the Bermuda Form in situations where there is damage to first-party property. New York courts interpreting the standard-form commercial general-liability (CGL) insurance policies (which often contain broadly similar, though not identical, exclusions) have held that the policy may respond to the extent that costs incurred in relation to first-party property were necessary to prevent or mitigate future damage or injury to another or another's property.

In some cases, the New York courts have held that the owned-property exclusion does not prevent recovery of cleanup costs, where such cleanup is necessary to prevent future damage to third parties. *See Savoy Medical Supply Co. v. F&H Manufacturing Corp.* 776 F.Supp 703 (E.D.N.Y. 1991). The courts have reasoned that to deny coverage in such circumstances would not be in the public interest, as it would encourage parties to forego cleanup and then make a later claim following more extensive damage. Hence, in one case, it was held that the costs of cleaning up oil leaking from the insured's property to prevent pollution of a nearby river was covered despite an owned-property exclusion because it prevented damage to another's property. *See Banker's Trust Co. v. Hartford Accident & Indemnity Co.* 518 F. Supp 371 (S.D.N.Y.).

Policyholders should be aware that the Bermuda Form takes a broad definition of "owned-property" so that it includes all property under the insured's "care, custody and control." U.S. case law on "care custody and control" often focuses on the question of whether the insured exerted *sufficient* "care, custody and control." There is also a line of authority suggesting that one must determine whether the insured exercised supervision over the property before deciding whether the exclusion bites. This is a difficult area for insureds, especially those contracted to

provide services for another where there is a real risk of damage to that property (either directly or through contamination of the site).

The Pollution Exclusion

The pollution “exclusion” is something of a misnomer, because the Bermuda Form actually provides considerable cover for liabilities arising as a result of pollution.

The Bermuda Form deals with liabilities arising from a discharge of pollutants by saying that there is no cover for the liability *unless*:

- The liability is a product-pollution liability; or
- There is personal injury or property damage caused by a discharge of pollutants designed to mitigate or avoid personal injury or property damage that would otherwise be covered under the Bermuda Form, and notice is given to the insurer within 40 days; or
- There is a discharge of pollutants and the insured becomes aware of the discharge within 7 days of commencement, and notice is given to the insurer within 40 days.

“Discharge” and “pollutant” are defined terms. In essence, there is no “discharge” if the pollutant remains confined within the building or human-made structure in which the pollutant was initially located. A “pollutant” is widely defined to include solids, liquids, and gases that adversely affect the environment.

“Product pollution liability” means that there is a liability for personal injury or property damage arising out of the end use of the insured’s products provided such use (1) occurs after possession of the goods has been relinquished to others by the insured and (2) occurs away from premises controlled by the insured. So, for example, if an insured manufactures a defective product containing a pollutant that escapes and then causes damage, provided that the escape of that product took place away from premises controlled by the insured and after control had passed to another, then such a liability would usually be covered. This is particularly relevant to insureds producing products such as petroleum, or agricultural fertilizers where widespread use of the manufactured product leads to increased potential for environmental contamination.

Item (b) above provides cover where damage caused by a discharge of pollutants is the result of mitigating greater harm. This is pertinent when considering environmental risks and supports the common-sense position that it is better to cause less harm than greater. For example, it might be better to allow a tanker to leak damaging neighboring property than to allow it to explode, damaging more neighboring property (such damage would, *prima facie*, be covered under the Bermuda Form). Insureds should note the 40-day reporting requirement.

Item (c) above retains cover for environmental damage provided it comes to the attention of the insured and is reported to the insurer within the required periods. This reporting requirement is in addition to that generally required by the Bermuda Form and noted under the heading “Notice of Occurrence and Integrated Occurrence” above. This feature of the Bermuda Form can be said to



reiterate the policy's primary purpose: to provide catastrophe cover. The policy is not designed to assist an insured that has been allowing, say, oil to leak for years from its site into the groundwater. The policy should respond if the insured's chemical-storage tank suddenly fails, spilling into the groundwater or onto neighboring properties.

Because New York law commonly governs the Bermuda Form, the pollution exclusion may be construed in accordance the New York courts' rulings on pollution exclusions under CGL policies. The general message from the appellate courts across the United States seems to be that pollution exclusions are designed to deal only with broadly dispersed environmental pollution and should not be construed in such a way as to cut down the policy's response to traditional tort claims. *See, e.g. Belt Painting Corp. v. TIG Insurance Co.* 763 NYS 2d 790 (N.Y. 2003).

The Toxic-Substances Exclusion

The Bermuda Form excludes cover for liabilities arising out of any manufacture, use, or exposure to various substances. Importantly, from an environmental perspective, this list of substances includes asbestos. The Bermuda Form retains cover where there is property damage arising out of asbestos not contained in the insured's products as a result of explosion, hostile fire, or lightning. So if there were an explosion of a manufacturing plant that contained asbestos such that the asbestos were widely disbursed resulting in high cleanup costs and property damage to third parties, this should not be excluded under the policy.

Nuclear Exclusion

For liabilities arising within the United States, there is a carefully crafted exclusion excluding most claims that could be made for property damage, personal injury, or advertising liability resulting from exposure to nuclear material. Liability of any nature directly or indirectly caused or contributed to by radiation or radioactive contamination from nuclear fuel or nuclear waste outside the United States is excluded. U.S. corporate policyholders seeking Bermuda Form cover for liabilities that could arise from nuclear contamination, such as that recently seen at Fukushima, should be aware of this provision. Policyholders using nuclear material should seek specialist advice.

Is There Cover?

Many of the features of the Bermuda Form are unique. The brokers placing this cover should have specialist knowledge of its terms and be able to provide guidance to risk managers and corporate counsel grappling with its provisions. A body of lawyers in London and the United States has formed with knowledge of the Bermuda Form, which it is important to access should a dispute arise. This is especially significant given that arbitration awards are confidential and reported decisions that might otherwise provide guidance on the Bermuda Form are rare.

Summary

- Understanding the "occurrence reported" provision is essential to understanding Bermuda Form cover.

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- “Expected or intended” losses are not covered.
- Generally, damage caused to the insured’s own property is excluded.
- There is cover on defined terms for discharge of pollutants.
- Disputes are resolved by an arbitration in London or Bermuda, usually applying modified New York law.

This article is not intended to provide specific advice, and regard will be needed for the terms of each policy and the circumstances giving rise to a claim.

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Insurers’ Duty to Settle in the Context of a Continuous-Trigger Case

By Kenneth Anspach

What is the scope of the insurers’ duty to settle in a case involving a continuous trigger of coverage? Is it pro rata, as the carriers would argue, or is it joint and several, which the insureds would assert? Further, what is the impact of the insurer having a fairly debatable defense to coverage based upon an honest belief that its coverage has not been triggered?

The Duty to Settle

The duty to settle arises out of the grant of coverage set forth in the primary commercial or comprehensive liability policy as follows:

The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of

- A. bodily injury or
- B. property damage

to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent, *and may make such investigation and settlement of any claim or suit as it deems expedient . . .* (Emphasis added.)

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Atl. Mut. Ins. Co. v. Am. Acad. of Orthopaedic Surgeons, 315 Ill. App. 3d 552, 560, 734 N.E.2d 50 (1st Dist. 2000). Thus, the primary policy dictates that the insurer “may make such investigation and settlement of any claim or suit as it deems expedient.”

Language granting the insurer the right, either on its own or together with the insured, to settle the claim “as it deems expedient” seems to grant the insurer broad discretion in this area. In fact, the duty is mandatory, as set forth in *Brockstein v. Nationwide Mutual Insurance Co.*, as follows:

While this broad statement appears to give the insurer unlimited settlement discretion, such is not the case—and for good reason. The policy confers upon the insurer the exclusive right to decide whether to settle or defend, but that decision may affect not only its own interest but also that of the insured. Since the insurer has that exclusive right, it must take responsibility for its exercise. While the insurer has an interest in paying out as little as possible on claims covered by its policies, the insured has an interest in not being exposed to a judgment beyond the policy limit. When these two interests conflict, the company has the unenviable duty of dealing fairly with them both.

Brockstein v. Nationwide Mut. Ins. Co., 417 F.2d 703, 705 (2nd Cir. 1969). In other words, while language granting an insurer authority to settle the claim “as it deems expedient” seems to grant the insurer broad discretion in this area, it does not, and the duty must be exercised fairly.

The duty to settle arises out of the duty to defend, and specifically out of the power afforded to the insurance company under the insurance policy to control the settlement decision. As the court stated in *Cramer v. Insurance Exchange Agency*:

The “duty to settle” arises because the policyholder has relinquished defense of the suit to the insurer. The policyholder depends upon the insurer to conduct the defense properly. In these cases, the policyholder has no contractual remedy because the policy does not specifically define the liability insurer’s duty when responding to settlement offers. The duty was imposed to deal with the specific problem of claim settlement abuses by liability insurers where the policyholder has no contractual remedy. (Citations omitted.)

Cramer v. Ins. Exch. Agency, 174 Ill. 2d 513, 526, 675 N.E.2d 897 (1996).

Therefore, the duty to settle is derivative of the duty to defend. Further, the exercise of the duty to settle relies upon a duty of good faith that is implied in the insurance contract, set forth in *Iowa Physicians’ Clinic Medical Foundation v. Physicians Insurance Co. of Wisconsin*, as follows:

An insurer's duty to settle in good faith on behalf of its insured, which is well-settled in Illinois***arises from the covenant of good faith and fair dealing implied in an insurance contract. This duty is a narrow exception to the Illinois courts' otherwise steadfast refusal to recognize an independent tort arising from the breach of this contractual covenant. *** The paradigmatic duty-to-settle case involves three parties: the injured third party; the insured, who is being sued; and the insurer, who controls the insured's defense. If the third party sues the insured for an amount above the policy limit and seeks a settlement at the upper limit of the policy, a conflict of interests arises. In this situation, the insurer may be tempted to decline the settlement offer, no matter how good the deal is for the insured, and go to trial. It makes no difference to the insurer's bottom line whether the case is settled or the jury awards astronomical damages; in either event it will pay out only the maximum on the policy. And if the case goes to trial, at least there's a shot that they will win and pay nothing. The insured, on the other hand, calculates the risks of trial differently because he will be stuck paying anything above the policy limit. ***. To combat the temptation to ignore an insured's interest and to make sure that the intent behind the insurance contract is upheld, Illinois courts have recognized that an insurer has a "duty to act in good faith in responding to settlement offers," and if that duty is breached the insurer is on the hook for the entire judgment, regardless of the policy limit. *** (Citations omitted.)

Physicians' Clinic Med. Found. v. Physicians Ins. Co. of Wisc., 547 F.3d 810, 812 (7th Cir. 2008). Thus, the exercise of the duty to settle relies upon a duty of good faith implied in the insurance contract. It requires an insurance company to "act in good faith in responding to settlement offers" such that it may be required to accept a settlement demand of payment of policy limits to protect its insured against the risk of an even higher judgment that may be later imposed at trial. Should the insurer ignore this duty, "the insurer is on the hook for the entire judgment, regardless of the policy limit." *Physicians' Clinic Med. Found.*, 547 F.3d at 812.

In Illinois, the cases are legion requiring that the insurer employ good faith in exercising the duty to settle. In construing a policy of liability insurance reserving to the insurance company the right to "make such investigation, negotiation and settlement of any claim or suit as it deems expedient," the court in the seminal case of *Cernocky v. Indemnity Insurance Co. of North America*, held:

We hold it to be the law of Illinois that in investigating, defending, considering questions of settlement, and on the question of appeal, the insurance company must give the interests of the insured equal consideration with its own interests and it must in all respects deal fairly with the insured.

Cernocky v. Indem. Ins. Co. of N. Am., 69 Ill. App. 2d 196, 201–208, 216 N.E.2d 198 (2nd Dist. 1966) held, quoting *Ballard v. Citizens Cas. Co. of N.Y.*, 196 F.2d 96, 102 (7th Cir. 1952). Thus, the duty to settle arises in the context of the duty to defend to which is applied a duty to “deal fairly with the insured.”

One well-known treatise has parsed the origin of the duty to settle between the duty to defend and the duty to indemnify, stating:

Negotiating to reach a settlement can be seen as part of the duty of defense. But *paying* (or agreeing to pay) the claimant an amount agreed to in settlement of the asserted claims is a clear aspect of the duty to indemnify, rather than, as sometimes suggested, of the duty to defend. (Emphasis added.)

William T. Barker and Ronald D. Kent, *New Appleman Insurance Bad Faith Litigation*, 2nd Edition, at 2–6. Unfortunately, the authority for this conclusion is not stated and appears to be absent. The splitting of the duty to settle between a duty to *pay*, as opposed the duty to *negotiate*, a settlement appears to be one that potentially gives insurers, who would undoubtedly rather negotiate than pay, justification for not paying, and thus for not honoring the duty to defend. Moreover, such an approach would be particularly confusing in determining the duties of insurers on a claim where there is a continuous trigger of coverage.

Multiple Primary Insurers on a Continuous Trigger Claim

What happens, for example, where a complaint pending in state court in Illinois alleging continuous occupational exposure to a harmful chemical such as benzene, resulting in leukemia and death, is being actively defended by the insured’s primary carriers, and the plaintiff, the decedent’s surviving spouse, presents a settlement demand within the policy limits? Suppose further that the primary carriers’ chosen panel counsel advises that if the demand is not accepted, there is a substantial likelihood of a judgment at trial in excess of the limits of the various primary policies on the risk. Suppose further that, while the complaint does not allege specific dates of exposure, one coworker’s deposition testimony pinpoints exposure during periods when the insured had policies with large self-insured retentions; these policies would be the sole policies triggered under a pro rata approach to allocation of liability for the proposed settlement, leaving the other primary carriers off the hook. Accordingly, the other primary carriers are unwilling to grant panel counsel settlement authority. Finally, suppose that other deposition testimony is inconclusive regarding the dates of decedent’s exposure.

The Joint-and-Several Nature of the Duty to Settle

As stated above, the case authority indicates that the duty to settle is a derivative of the duty to defend. Insurers recognize that the scope of the duty is defined solely by reference to the allegations in the complaint. As the Illinois Supreme Court held in *United States Fidelity & Guaranty Co. v. Wilkin Insulation Co.*:

To determine an insurer's duty to defend its insured, the court must look to the allegations in the underlying complaints. If the underlying complaints allege facts within or *potentially* within policy coverage, the insurer is obliged to defend its insured even if the allegations are groundless, false, or fraudulent. *** An insurer may not justifiably refuse to defend an action against its insured unless it is *clear* from the face of the underlying complaints that the allegations fail to state facts which bring the case within, or potentially within, the policy's coverage. *** (Citations omitted; emphasis in original.)

U.S. Fid. & Guar. Co. v. Wilkin Insulation Co., 144 Ill. 2d 64, 73, 578 N.E.2d 926 (1991).

Because in the example the allegations in the complaint fail to specify dates of exposure, the primary carriers whose policies are even *potentially* triggered must defend. In that respect, the example is similar to *Illinois Tool Works Inc. v. The Home Indemnity Co.*, where the court stated:

Although the complaints do not specify the dates during which the contamination took place, it is not far-fetched to imagine that the contamination occurred during the American policy period—from 4/15/88 to 4/15/89. Illinois courts have adopted a “commonsense interpretation” when evaluating the pleadings to avoid leaving the insured “at the mercy of its adversary’s pleading skills.” *** Under a commonsense interpretation, this occurrence was “potentially” within the policy period when American was asked to defend these actions. (Citations omitted.)

Ill. Tool Works Inc. v. The Home Indem. Co., 998 F. Supp. 868, 873 (N.D. Ill. 1998). Similarly, here, primary carriers' obligation to defend is based upon the complaint in the underlying suit, even though it does not specify dates of exposure.

The present example is not unlike that of *Consolidated Rail Corp. v. Liberty Mutual Insurance Co.*, where the insurer sought to evade its duty to defend based upon its own independent investigation of the facts. In holding that the insurer had thereby breached its duty to defend, the court stated:

The law is well settled in Illinois that an insurer is obligated to defend in those actions where the complaint alleges facts potentially within the coverage of the policy. *** In determining whether there is potential coverage, only the allegations of the complaint may be consulted. *** *Independent investigations revealing facts which conflict with those alleged in the complaint do not relieve the insurer of his duty to defend.* (Citations omitted; emphasis added.)

Consol. Rail Corp. v. Liberty Mut. Ins. Co., 92 Ill. App. 3d 1066, 1070, 416 N.E.2d 758 (5th Dist. 1981).



Similarly, in *Chandler v. Doherty*, where the insurer possessed strong evidence that the putative insured's car was not covered by the insurance policy, the court found that the insurer unjustifiably refused to defend. The court further found that:

Under Illinois law a liability insurer's duty to defend arises when the insured tenders defense of a suit against him that alleges facts which, when taken as true, raise the potential for coverage occurring during the effective policy period. *** It is the law of this state that in determining whether it has a duty to defend a suit, an insurer is *limited* to comparing the bare allegations of the complaint with the face of the policy of insurance***.

The threshold a complaint must meet to present a claim for potential coverage, and thereby raise a duty to defend, is minimal. ***. Any doubts about potential coverage and the duty to defend are to be resolved in favor of the *insured*. ***The duty to defend is not annulled by the knowledge on the part of the insurer the allegations are untrue or incorrect or the true facts will ultimately exclude coverage. 292 Ill. App. 3d at 801–802. (Citations omitted; emphasis in original.)

Chandler v. Doherty, 299 Ill. App. 3d 797, 702 N.E.2d 634 (4th Dist. 1998). Thus, Illinois law is very clear that “[t]he duty to defend is not annulled by the knowledge on the part of the insurer the allegations are untrue or incorrect or the true facts will ultimately exclude coverage.” *Chandler v. Doherty*, 299 Ill. App. 3d at 801–802.

In the stated example, a coworker's deposition testimony pinpointed dates of exposure to benzene to a specific period. At first blush, this testimony may seem to justify a refusal to accept the plaintiff's settlement demand. However, as set forth in *Consolidated Rail Corp. v. Liberty Mutual Insurance Co.* and *Chandler v. Doherty*, nothing in Illinois law would allow deposition testimony to supercede the import of the allegations of the complaint when determining the scope of the duty to defend or the duty to settle arising therefrom. The closest the Illinois courts have come to allowing pretrial evidence to play any role in a coverage determination was in allowing a federal pretrial order to be considered in defining the scope of the duty to *indemnify*, not the duty to defend. In *McDonald's Corp. v. American Motorists Insurance Co.* the court noted that:

This case involves whether the insurers had a duty to *indemnify* McDonald's in the settlement of the *Thermodyne* litigation. The duty to indemnify is much narrower than the duty to defend. Unlike the duty to defend, the duty to indemnify cannot be determined simply on the basis of whether the factual allegations of the underlying complaint potentially state a claim against the insurer . . .

In federal litigation, the final pretrial order supercedes the complaint. See e.g., *Ash v. Wallenmeyer*, 879 F.2d 272, 274 (7th Cir. 1989) (noting the effect of the pretrial order is to

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supersede the pleadings); *Ghandi v. Police Department*, 823 F.2d 959, 962 (6th Cir. 1987) (same); *Hoagburg v. Harrah's Marina Hotel Casino*, 585 F.Supp. 1167, 1175 (D. N.J. 1984) (same). Therefore, in addition to examining the allegations of the underlying complaint, we will consider also the allegations as set forth in the final pretrial order. (Emphasis added.)

McDonald's Corp. v. Am. Motorists Ins. Co., 321 Ill. App. 3d 972, 979, 748 N.E.2d 771 (2d Dist. 2001).

Thus, in federal litigation only, Illinois courts recognize that the final pretrial order supercedes the complaint. Yet, here, the underlying suit is in *state court*. Moreover, the specific period of exposure is not in a pretrial *order*, but in deposition testimony.

That the insurer may not base a determination regarding the duty to defend, and, hence, the duty to settle, upon matters outside the complaint makes perfect sense in the context of the underlying complaint. Yet, insurers, and particularly the primary carriers under this example, would assert that the basis for any settlement is the duty to *indemnify*, not the duty to *defend*. The benefit to the insurers in asserting that the duty to settle arises out of the duty to indemnify, rather than out of the duty to defend, is that insurers believe that they may then allocate the cost of their duty to settle on a pro rata, rather than on a joint-and-several basis. This method of allocation effectively limits their exposure in the cost of paying claims to only a piece of the pie, rather than the whole thing. This method of allocation also potentially allocates to the insured a portion of the indemnity costs for any gaps in coverage due to carrier insolvencies, coverage buy-backs, self-insured retentions, or lack of insurance. Yet, this method of allocating payment under a duty to settle ignores the numerous judicial decisions, such as *Cramer*, *Cernocky*, and *Haddick v. Valor Insurance*, (*Haddick v. Valor Ins.*, 198 Ill. 2d 409, 763 N.E.2d 299 (2001)) which link the duty to settle to the duty to defend, in that the duty to settle is created by the “conception of the insurance contract *** because the policyholder relinquishes his right to negotiate settlement on his own behalf when he enters into the contract. . . .” (*Haddick*, 198 Ill. 2d at 413.) Thus, primary carriers have an already existing duty to settle created because they entered into their respective insuring agreements with the insured. It is that duty that governs their responsibility relative to settlement, not the duty to indemnify.

Moreover, the duty to indemnify is actually inapplicable because, for any settlement that has occurred prior to the entry of judgment, the duty to indemnify will not yet have even arisen. As set forth in *Outboard Marine Corp. v. Liberty Mutual Insurance Co.*:

An insurer's duty to indemnify is narrower than its duty to defend its insured. *** The duty to indemnify “will not be defined until the adjudication of the very action which [the insurer] should have defended.” *** In other words, the question of whether the insurer has a duty to indemnify the insured for a particular liability is only ripe for consideration if the insured has already incurred liability in the underlying claim against it. *** If so,

the duty to indemnify arises if the insured's activity and the resulting loss or damage *actually* fall within the CGL policy's coverage. *** (Citations omitted.)

Outboard Marine Corp. v. Liberty Mut. Insurance Co. (Outboard Marine II), 283 Ill. App. 3d 630, 670 N.E.2d 740 (2nd Dist. 1996). Thus, in the settlement situation posed in the example, the duty to indemnify would not be ripe because there has been no adjudication.

The "All Sums" Approach to Indemnification Amongst Continuously Triggered Primary Carriers

Even assuming *arguendo* that the duty to settle arises out of the duty to *indemnify* rather than the duty to *defend*, the primary carriers must still exercise their duty to settle in the example, because the duty to indemnify is *also* joint and several. That is so, because the duty to indemnify arises out of the "all sums" portion of the grant of coverage, which states, "The company will pay on behalf of the insured *all sums* which the insured shall become legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies caused by an occurrence . . ." See, e.g., *Ludwig Candy Co. v. Iowa Nat'l Mut. Ins. Co.*, 78 Ill. App. 3d 306, 396 N.E.2d 1329 (1st Dist. 1979). This "all sums" approach to indemnification amongst continuously triggered primary carriers was first adopted by the Illinois Supreme Court in *Zurich Insurance Co. v. Raymark Industries, Inc. Zurich Ins. Co. v. Raymark Indus., Inc.*, 118 Ill. 2d 23, 514 N.E.2d 150 (1987). In *Zurich*, the court addressed the trigger of insurance coverage in cases involving bodily harm from asbestos exposure. The court adopted the position advocated by the insured, that "each carrier whose policy is triggered is jointly and severally liable for the total indemnity and defense costs of a claim without proration," holding as follows:

The appellate court relied on the language of the policies. Zurich undertook to "pay on behalf of [Raymark] all sums which [Raymark] shall become legally obligated to pay as damages because of * * * bodily injury * * * caused by an occurrence." Zurich further agreed "to defend any suit against [Raymark] seeking damages on account of such bodily injury." The court found nothing in the policy language that permits proration. Zurich urges this court to adopt the pro rata approach set forth in *Insurance Co. of North America v. Forty-Eight Insulations, Inc.* (6th Cir. 1980), 633 F.2d 122, *aff'd on rehearing* (1981), 657 F.2d 814, *cert. denied* (1981), 454 U.S. 1109, 70 L. Ed. 2d 650, 102 S. Ct. 686.

. . . Having rejected the premise underlying the *pro rata* approach adopted in *Forty-Eight Insulations*, we conclude that the appellate court did not err insofar as it declined to order the *pro rata* allocation of defense and indemnity obligations among the triggered policies. (Emphasis in original).

Zurich Insurance Co., 118 Ill. 2d at 49–51. Thus, *Zurich* holds that indemnity obligations should be allocated on a joint-and-several basis. Even so, insurers assert, and particularly would assert under this example, that their obligation to settle must be allocated on a pro rata basis. Insurers

justify this position on the following cases: *United States Gypsum Co. v. Admiral Insurance Co.*, *U.S. Gypsum Co. v. Admiral Ins. Co.*, 268 Ill. App. 3d 598, 643 N.E.2d 1226 (1st Dist. 1995); *Outboard Marine II*, 283 Ill. App. 3d 630, 670 N.E.2d 740 (2nd Dist. 1996); and *AAA Disposal Systems, Inc. v. Aetna Casualty and Surety Co.*, *AAA Disposal Sys., Inc. v. Aetna Cas. and Surety Co.*, 355 Ill. App. 3d 275, 821 N.E.2d 1278 (1st Dist. 2005). Yet, these cases do not even address the issue of allocation at the primary coverage level. Instead, these cases merely deal with the issue of horizontal exhaustion as it relates to excess and umbrella coverage, and must be accordingly discounted. For an in-depth discussion of *U.S. Gypsum*, *Outboard Marine II*, and *AAA Disposal*, see Kenneth Anspach, *The Illinois Pro Rata Myth*, Coverage, Volume 19, Number 5 at 4–5 (September/October 2009).

The only instance where the viability of a pro rata approach to settlement has thus far arisen before the Illinois Supreme Court was in its decision in *Employers Insurance of Wausau v. Ehlco Liquidating Trust*, where it was rejected. *Emp'rs Ins. of Wausau v. Ehlco Liquidating Trust*, 186 Ill.2d 127, 157, 708 N.E.2d 1122 (1999). In *Ehlco*, an insurer with an identifiable pro rata share of liability in a continuous-trigger case was found liable for the entire amount of the settlement. While not explicitly discussing the duty to settle, the court found that an insurer who had only offered to pay a 9 percent pro rata share of the settlement amount was liable for the *entire* settlement amount. The court stated:

[I]n June of 1992, Ehlco informed Wausau of a \$1.3 million settlement offer by Union Pacific. Wausau did not object to the reasonableness of this settlement offer. Rather, Wausau merely offered to pay 9% of the settlement and 9% of the defense costs incurred. Ehlco then settled the suit and, as a result, the district court dismissed the suit with prejudice on November 5, 1992. Wausau did not file its complaint seeking declaratory judgment of noncoverage with regard to the Wyoming suit until February 26, 1993. This was almost four months after the underlying suit was concluded. Thus, Wausau's declaratory judgment action was untimely as a matter of law.

Based on an application the estoppel rule for the insurer's failure to defend and the tardiness of the insurer's declaratory-judgment action, the court affirmed the ruling of the trial court finding Wausau liable, *inter alia*, for the entire amount of the settlement. While the decision was not based upon the duty to settle, it is nevertheless instructive regarding the court's approach to these issues.

Offers for Settlement Within the Limits of the Insurance Policy

Suppose the primary carriers in the example simply refuse to settle the underlying case on the basis of a "fairly debatable" coverage defense, i.e., that their primary policies have not been triggered, regardless of the scope of the duty to settle. The majority rule in this area is that reasonable beliefs about coverage do not excuse a failure to settle if settlement was otherwise the appropriate course of action. A leading case representative of that rule is *Western Casualty & Surety Company v. Herman. West. Cas. & Sur. Co. v. Herman*, 405 F.2d 121 (8th Cir. 1968),

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which held that “notwithstanding an honest belief by the insurer that the policy is not in effect, the company must in good faith consider offers for settlement within the limits of the insurance policy.” (Citations omitted.) *West. Cas. & Sur. Co. v. Herman*, 405 F.2d at 123.

In Illinois, the majority rule was followed in *Transport Insurance Company, Inc. v. Post Express Co., Inc. Transport Ins. Co., Inc. v. Post Express Co., Inc.*, 138 F. 3d 1189 (7th Cir. 1997). There, the insurer based its failure to take advantage of an opportunity to settle before trial upon a late-notice defense to coverage. The district court agreed. The court of appeals reversed, finding that the insurer had waived the late-notice defense. The court further held that a “fairly debatable” defense to coverage does not authorize the insurer “to throw its client’s interests to the winds” and fail to exercise its “fiduciary duty” to settle on favorable terms below the policy limits. *Transport Ins. Co.*, 138 F. 3d at 1193.

In so holding, the *Transport Insurance Co.* court distinguished an Illinois state-court decision, *Stevenson v. State Farm Fire & Casualty Company, Stevenson v. State Farm Fire & Cas. Co.*, 257 Ill. App. 3d 179, 628 N.E.2d 810 (1st Dist. 1993), and a decision of the Wisconsin Supreme Court, *Mowry v. Badger State Mutual Casualty Insurance Company, Mowry v. Badger State Mutual Cas. Ins. Co.*, 129 Wis. 2d 496, 385 N.W.2d 171 (1986), both of which represent the minority view on this subject. The *Stevenson* court, in expressing that view noted that an insurance carrier must give its insured’s interest consideration equal to its own in negotiating settlements on behalf of its insured. *Stevenson*, 257 Ill. App. 3d at 183. However, the court found that where a carrier can reasonably examine a set of facts and determine that the incident or occurrence that is the substance of the underlying controversy is not one contemplated by the policy, then it does not owe the same kind of duty as that otherwise required. *Stevenson*, 257 Ill. App. 3d at 183–84. Similarly, in *Mowry* the court found that bad faith in deciding to litigate rather than settle a claim involves more than a mere finding of negligence on the part of the insurer. *Mowry*, 129 Wis. at 515–16.

The court further opined that where there is no bad faith, an insured may not surcharge an overage against his or her insurance company merely because of any possible negligence on the insurer’s part in deciding to litigate rather than to settle. *Id.* An insurer will have committed the tort of bad faith, the court found, only when it has denied a claim without a reasonable basis for doing so, that is when the claim is not fairly debatable. *Mowry*, 129 Wis. at 515–16.

In analyzing both *Stevenson* and *Mowry*, the *Transport Insurance Company* court found that:

Stevenson and *Mowry* have a vital fact in common: in each case the insurer, after contesting coverage, arranged for the insured to be represented by independent counsel. When this happens, there is little need to protect the insured from the carrier, and a potential need to protect the carrier from the insured. *Stevenson* remarked that “a carrier is required to provide independent counsel for its insured” in these situations. In *Mowry* Justice Steinmetz observed: “the duty to settle is not a contractual duty . . . Rather it is a



fiduciary duty which only arises when the insurer assumes the exclusive management and control of the insured's defense." ***

Transport Ins. Co., 138 F. 3d at 1193. The *Transport* court concluded that, unlike in *Stevenson* and *Mowry*, because Transport Insurance had failed to authorize the insured to hire independent counsel, it was required to "give the insured's exposure equal weight with its own." *Id.*

In thereby distinguishing *Stevenson* and *Mowry*, the court exposed the fallacy behind the minority views represented by those decisions. Neither *Stevenson* nor *Mowry* were true "duty to settle" cases. Given that in each, the insured was represented by independent counsel, the necessary predicate to the exercise of such a duty, i.e., that the insurer have exclusive management and control of the insured's defense, did not exist. Accordingly, no duty was owed to the insured, regardless of the existence of a "fairly debatable defense." Thus, in the present example, where the insured is being represented by panel counsel, the majority rule must apply that "notwithstanding an honest belief by the insurer that the policy is not in effect, the company must in good faith consider offers for settlement within the limits of the insurance policy." *West. Cas. & Sur. Co. v. Herman*, 405 F.2d at 123.

In conclusion, the primary carriers' duty to settle in a case involving a continuous trigger of coverage is joint and several. Further, even if the primary carriers have a fairly debatable defense to coverage based upon an honest belief that their coverage has not been triggered, the primary carriers must in good faith consider offers for settlement within the limits of the primary policies.

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NEWS & DEVELOPMENTS

High Court Reverses Second Circuit in Climate Change/Nuisance Case

On June 20th, the U.S. Supreme Court in *AEP v. Connecticut* [reversed](#) the Second Circuit and rejected the application of nuisance common law by the states. The Court held that the Clean Air Act vests in the EPA the authority to regulate greenhouse gas (GHG) emissions, including carbon dioxide. This decision furthers the decision in 2007 wherein the Supreme Court held that

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the EPA had the authority under the Clean Air Act to regulate emissions of carbon dioxide from vehicles. The states had filed suit because the EPA had not acted under the federal common law of nuisance, which was the basis of the Second Circuit's decision below. The conundrum caused by the case is that if Congress were to remove the authority under the Clean Air Act to regulate greenhouse gases the effect would be to resuscitate the federal common law of nuisance for states such as the Northeast states to return to court. The EPA has said it will regulate such gases by a series of proposals in May 2012.

In this closely watched case, eight states and three land trusts sought to impose limits on GHGs from five major electric power companies on the grounds that those emissions were a violation of federal common law because they contributed to global warming. The Supreme Court held that any federal common law right to seek to control such emissions judicially was displaced by the Clean Air Act. In an 8–0 decision authored by Justice Ginsburg, the Supreme Court overturned the Second Circuit's ruling that the Clean Air Act did not displace federal common law on this issue. The Second Circuit's decision was based in part on the fact that the EPA had not yet promulgated its rules regulating GHG emissions. (Justice Sotomayor did not take part in the Supreme Court's decision on this case because she sat on the Second Circuit at the time that it issued its decision.) The Supreme Court disagreed, stating that the critical point was “that Congress delegated to EPA the decision whether and how to regulate carbon-dioxide emissions from power plants; the delegation is what displaces federal common law.” The fact that the EPA had not yet exercised that authority by issuing final regulations did not negate the delegation—or the displacement of federal common law.

While the Court was unanimous in its ruling on the EPA's occupation of the GHG regulatory realm, article III standing was affirmed only by a divided Court. Specifically, the Court split 4–4 on the potentially key legal issue of whether federal courts have jurisdiction to hear such suits, or whether they are barred by the political-question doctrine. The split here means that the Second Circuit finding that the suits could proceed stands, although that ruling does not apply to other federal circuits.

Going forward, it should be noted that the Supreme Court did not address whether the plaintiffs could obtain relief under state nuisance law. The Second Circuit did not address the state-law claims because it decided the issue based on federal common law. The Court therefore left the potential availability of a claim under state nuisance law open for consideration on remand. As a result, the Supreme Court's decision will not mean an immediate end to nuisance claims over climate change.

For further information please see the [article](#) by Christina M. Landgraf and Joel T. Bowers of Barnes & Thornburg LLP.

— [John H. Klock](#), *Gibbons P.C., Newark, NJ* and [Robert L. Hines](#), *Farella Braun & Martel LLP, San Francisco, CA*

Cert Denied to GE's Petition Challenging EPA's Superfund Authority

In December 2010, General Electric (GE) filed a petition for certiorari with the U.S. Supreme Court, asking for review of a D.C. Circuit decision in *Gen. Electric Co. v. Jackson*, 610 F.3d 110 (D.C. Cir., 2010).

GE had originally sued the EPA in 2000, arguing that the EPA's use of "unilateral administrative orders" (UAOs) violated the due process clause of the Constitution. The EPA uses UAOs in ordering cleanup of Superfund sites from potentially responsible parties under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).

When the EPA determines that an environmental cleanup is necessary at a contaminated site, CERCLA gives the agency four options: (1) It may negotiate a settlement with potentially responsible parties (PRPs), (2) it may conduct the cleanup with "Superfund" money and then seek reimbursement from PRPs by filing suit, (3) it may file an abatement action in federal district court to compel PRPs to conduct the cleanup, or (4) it may issue a UAO instructing PRPs to clean the site. This last option, authorized by CERCLA section 106, is the focus of this case.

To use its UAO authority, the EPA must first determine "that there may be an imminent and substantial endangerment to the public health or welfare or the environment because of an actual or threatened release of a hazardous substance from a facility." If the EPA makes such a determination, it must then compile an administrative record and select a response action. For remedial actions, the EPA must give notice to PRPs and the public, provide an opportunity to comment and submit information about the remedial plan, and give other participation opportunities to PRPs throughout the process. Once the UAO is issued, the PRP may either comply and then seek reimbursement from the EPA, or refuse to comply and force the EPA to bring an enforcement action in court. If, however, the PRP refuses to comply and the court finds that the PRP's refusal was willful and without sufficient cause, the court may impose fines up to \$37,500 per day. In addition, if the EPA decides to undertake remediation itself while the court action is proceeding, the court can also impose damages against the PRP of up to three times the actual cost incurred for clean up.

GE sued, arguing that the UAO provisions violated the Fifth Amendment because it deprived entities of their fundamental right to liberty and property without . . . constitutionally adequate procedural safeguards. In particular, GE argued that the UAOs deprive PRPs of two types of protected property: (1) the money PRPs must spend to comply with a UAO or the daily fines and treble damages they face should they refuse to comply; and (2) the PRPs' stock price, brand

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value, and cost of financing, all of which, GE contends, are adversely affected by the issuance of a UAO. Because of the extremely large amount of potential fines faced by PRPs who refuse to comply, the “refuse to comply” option was, GE argued, only theoretical as no PRP could afford to face that risk. Thus, automatic compliance with a UAO was the only realistic option faced by any target of such an order.

The district court found that the EPA’s actions under the UAO provisions of CERCLA were not unconstitutional. The court of appeals agreed:

To the extent the UAO regime implicates constitutionally protected property interests by imposing compliance costs and threatening fines and punitive damages, it satisfies due process because UAO recipients may obtain a pre-deprivation hearing by refusing to comply and forcing EPA to sue in federal court. Appellant insists that the UAO scheme and EPA’s implementation of it nonetheless violate due process because the mere issuance of a UAO can inflict immediate, serious, and irreparable damage by depressing the recipient’s stock price, harming its brand value, and increasing its cost of financing. But such “consequential” injuries—injuries resulting not from EPA’s issuance of the UAO, but from market reactions to it—are insufficient to merit Due Process Clause protection.

GE then filed its petition with the Supreme Court, again arguing that stock prices were adversely affected without due-process protections when a UAO was issued and that the “refuse to comply” option was unrealistic, given the amount of potential fines faced. The EPA disagreed, noting that there were substantial opportunities for the PRP to receive notice and hearing throughout the UAO and enforcement process. The EPA also pointed out the PRPs’ option to start cleanup and then sue the EPA for reimbursement. In addition, the EPA argued that CERCLA itself does not impose treble damages plus penalties for noncompliance; only a federal court can impose fines or punitive damages for such noncompliance and only after the potentially responsible party has been given an opportunity to present its case, the government said.

The Supreme Court denied review on Monday, June 6, 2011. The Supreme Court case number was 10-681. The appellate opinion is available at 610 F.3d 110 and is attached [here](#).

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Environmental Litigation

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