

INSURANCE UPDATE

June 12, 2006

Issue No. 61

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California Law - Liability Insurance – Environmental Liability

Environmental “Response Costs” Do Not Constitute “Damages” In The Absence Of A Lawsuit Against The Insured

CDM Investors v. Travelers Casualty & Surety Company - 06 C.D.O.S. 4490 California Court of Appeal, Sixth District, May 26, 2006

By David P. Borovsky and Howard M. Garfield

CDM, the owner of a commercial rental property, was ordered by the California Water Quality Control Board (the “Board”) to test the property for pollutants. CDM notified its insurance carriers of the order, and sought insurance coverage for the costs of compliance or “response costs”-- \$230,000 paid to an environmental consulting firm.

CDM’s insurers—a general liability insurer and an umbrella insurer—denied coverage, and the Board ultimately closed its investigation without initiating formal action. CDM sued its insurers for breach of contract, arguing that the “response costs” were covered. The trial court granted the insurers’ demurrers, and the appellate court affirmed.

Critically, both the liability policy and the umbrella policy contained “standard” policy language—i.e. both agreed to indemnify the insured only for sums which the insured became “legally obligated to pay as damages”. In the absence of a lawsuit, the appellate court reasoned, the insured could not become

legally obligated to pay *damages*. Thus, despite the fact that payment of the response costs in this case may have obviated the necessity of a lawsuit or settlement, CDM’s payment of these costs could not be characterized as amounts paid *as damages*.

The appellate court contrasted the result with the result in the California Supreme Court case of *Powerine Oil Co., Inc. v. Superior Court* (2005) 37 Cal.4th 377 (*Powerine II*). In *Powerine II*, the opposite conclusion was reached, in the context of an umbrella policy that agreed to indemnify “for damages, direct or consequential *and expenses* . . .” (emphasis added). Unlike the policy at issue in *Powerine II*, the policies issued to CDM limited the indemnity obligation to “damages”, and did not extend to “expenses”. Thus, the “response costs” at issue were not covered in the absence of a lawsuit.

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