

No Coverage for Defense Costs Incurred in Response to CERCLA Demand

Insurance Law Update

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U.S. Court of Appeals for the Fourth Circuit

In *Industrial Enterprises, Inc. v. Penn America Ins. Co.*, ___ F.3d ___, 2011 WL 925451 (4th Cir. (Md.) March 18, 2011), the U.S. Court of Appeals for the Fourth Circuit ruled that a commercial general liability (CGL) policy providing coverage for “sums which the insured shall become legally obligated to pay as damages because of ...property damage” did not cover an insured’s defense costs incurred in response to the Environmental Protection Agency’s (EPA) demand under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) to remediate the presence of hazardous substances on the insured’s land. The court ruled that the insured’s defense costs did not constitute “property damage” under the CGL policy because the insured’s potential liability under CERCLA arose from the EPA’s regulatory authority rather than the federal government’s rights as a property owner.

The court based its ruling on the decision in *Bausch & Lomb v. Utica Mutual Ins. Co.*, 330 Md.758 (Md. 1993), where the Maryland Court of Appeals held that a similar CGL policy did not cover an insured’s expenses incurred in response to a regulatory order from the state government requiring the removal of soil containing hazardous chemicals from the insured’s property. In *Bausch & Lomb*, the Fourth Circuit noted that the state government demanded the cleanup to protect groundwater on the insured’s property, not to address injury to property owned by the state. Although the court recognized that the state government’s statutory jurisdiction extended to the “waters of the State,” which included both surface and

underground water, the court rejected the argument that this jurisdiction amounted to a proprietary interest in the water within the contemplation of the insurance policy at issue.

The court ruled that the EPA's demand under CERCLA did not amount to an attempt to vindicate the government's rights as a property owner, but rather arose from the government's duty to regulate and remediate hazardous substances deposited on private property. Thus, the court held that the EPA's demand created only potential regulatory liability, but did not subject the insured to potential liability for damage to federal property. In addition, the court noted that its interpretation of the term "property damage" as applying to risks of tort damage, and not to costs arising from governmental regulation, was reasonable in light of the indeterminate nature of liability under CERCLA, which can often greatly exceed the value of the property to be cleaned.

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