

III. THE STRUCTURE OF LIABILITY INSURANCE POLICIES

This Section provides an overview of the basic structure of liability insurance policies, including the most prominent of features of these policies: the *Insuring Agreement* stating the scope of coverage provided, and a set of *Exclusions* and *Conditions* stating the limitations on and prerequisites to the coverage provided by the Insuring Agreement. In addition, this Section briefly reviews the three kinds of insurance policies that have figured in litigation over coverage against environmental liabilities: the CGL (formerly "Comprehensive General Liability" and now "Commercial General Liability") policy; special-purpose policies directed at environmental liability only ("Environmental Impairment Liability" and "Pollution Liability" policies); and Commercial Property Insurance. Copies of these policies themselves are set out in the Appendix following Chapter Seven.

A. Basic Structure

Insurance policies generally begin with a cover sheet containing *Declarations* regarding the effective date of the policy, the kinds of coverage provided, and the monetary limits of coverage. Many policies also contain other information regarding the identity and characteristics of the insured, the insured's risk classification, and the premium charged. Virtually all insurance policies are then divided into separate parts or sections bearing labels that describe the contents or function of the provisions in each part. A set of *Definitions* of the key terms and phrases employed throughout the policy is likely either to follow the Declarations immediately or to be placed at the very end of the policy. In policies that contain a series of Insuring Agreements providing different forms of coverage there may be a separate set of Definitions applicable to each form of coverage.

In the typical liability insurance policy the *Insuring Agreement* or Agreements and the *Exclusions* follow the Declarations. A separate provision that explicates the *Limits of Liability* specified in the Declarations is common. Most policies also contain a catch-all category that is likely to be labelled *Conditions*. Many of the provisions in this category state conditions of coverage. Other

provisions, however, may actually state additional obligations of the insurer or qualifications on the terms of coverage that are not stated in the form of conditions precedent. The structure of Commercial Property Insurance policies is somewhat different from that of liability insurance policies, since Property Insurance policies contain separate sections describing the property insured and the causes of loss covered.

Finally, when an insurer wishes to modify the terms of a standard-form policy the typical method of doing so is by attaching an *Endorsement* to the policy. An Endorsement may add to, exclude, modify, or qualify the coverage provided by the policy. Over the years some large businesses and their insurers have added a variety of endorsements to their policies, sometimes substantially modifying the coverage provided by the standard form, or even re-writing the policies into *manuscript* form, incorporating many standard provisions but modifying others.

B. The Insuring Agreement

The Insuring Agreement is the provision or set of provisions that specifies the insurance provided by the policy. The key provisions of several different Insuring Agreements are summarized in Section D of this Chapter. The typical Insuring Agreement in a liability insurance policy provides coverage against both liability and the costs of defending the insured against claims that would be covered by the policy if they were proved. Coverage normally is provided against specified forms of liability—e.g., all liability payable as damages because of bodily injury, or because of bodily injury or property damage arising out of the use of a motor vehicle.

Until relatively recently most liability insurance policies provided for a duty to defend even if a claim against the insured was “groundless, false, or fraudulent.” This phrase has been omitted from the Insuring Agreement of many newer policies, especially those written in so-called “plain language,” but for two reasons this omission probably does not restrict the scope of the duty to defend. First, insurers have expressed no intention to restrict the duty. Second, the older provision has merely been omitted from newer policies; those policies contain no exclusion from the duty to defend of particular kinds of claims and no clarification of the terms of the duty.

In the absence of any specification of the scope of the duty to defend in liability insurance policies themselves, common law elaboration of the scope of that duty is likely to continue to take place against the background of the duty to defend even "groundless, false, or fraudulent" claims.

C. Exclusions and Conditions

Since Chapter Four of this book is devoted to the most prominent Exclusions and Conditions in CGL insurance policies, there is no need here to discuss these kinds of provisions in detail. It is useful to understand, however, that most Exclusions in liability insurance policies are designed primarily to deal with one or both of two problems: *moral hazard* and *adverse selection*.³⁸ Broadly conceived, moral hazard is the tendency of an insured party to exercise less care to avoid insured losses than that party would exercise if the losses were uninsured. The clearest example of a moral hazard that would be created by liability insurance if an exclusion did not address it is action that is intended to cause harm. Virtually all liability insurance policies contain exclusions (or definitions of covered losses) precluding coverage of liability for intentionally-caused harm. If insurance against such liability were provided, then the very existence of insurance would promote loss and drive up the cost of coverage for all policyholders. Because many courts have held that insurance against intentionally-caused loss is against public policy,³⁹ in a sense exclusions against such loss are merely clarifications that confirm what the courts have held. Other exclusions and conditions, however, encourage the insured to take safety precautions or to mitigate losses in progress. These provisions are designed to combat more subtle forms of moral hazard that are not subject to implied exclusions on public policy grounds.

Adverse selection is the greater tendency of those who pose an above-average risk of suffering a loss to seek insurance against it. Many exclusions in typical liability insurance policies are directed at the problem. For example, the standard CGL policy contains an

38. For more detailed discussion of these concepts, See K. Abraham, *INSURANCE LAW AND REGULATION* 3-5 (1990).

39. See, e.g., *St. Paul Ins. Co. v. Talladega Nursing Home, Inc.*, 606 F.2d 631 (5th Cir. 1979).

exclusion of coverage against liability for injury or damage arising out of the sale of alcoholic beverages, and another exclusion of coverage against liability arising out of the operation of any aircraft, watercraft, or automobile. If a general liability policy covered these forms of liability, then businesses at greater risk of suffering them than others would disproportionately seek coverage, driving up the cost of insurance for others who were at lower risk of suffering these forms of liability. Consequently, coverage against these forms of liability (and a number of others as well) is excluded, and insurance against them is separately available under other policies, coverage parts, or endorsements, at a price commensurate with the risk posed by each insured.

Although the Exclusions in liability insurance policies are predominantly designed to combat moral hazard and adverse selection,⁴⁰ the Conditions are much more likely to be a conglomeration of unrelated provisions with varying purposes. Some of these provisions purport to create conditions precedent to coverage, such as those requiring the insured to provide the insurer with notice of a claim or suit; others create or confirm the insurer's duties, such as those providing that the insured's bankruptcy does not relieve the insurer of its obligations. Thus, it may be more accurate to describe the conditions contained in liability insurance policies as "General Provisions," as some automobile liability insurance policies have begun to do.

D. Types of Policies

Many different types of insurance policies could provide coverage against environmental liability under certain circumstances. For example, even the standard personal auto policy might provide coverage against such liability if an auto accident caused the discharge of a vehicle's gasoline into a public water supply.⁴¹ Despite the

40. A third purpose, keeping the cost of coverage reasonable, may also be served by certain exclusions.

41. The Insuring Agreement of the standard-form auto policy provides that the insurer

* * * will pay damages for "bodily injury" or "property damage" for which any "insured" becomes legally responsible because of an auto accident.

possibility of such coverage, however, this Section focuses on the three types of policies that have figured most often in environmental liability insurance disputes: 1) the Comprehensive (now "Commercial") General Liability insurance policy, or CGL; 2) special-purpose liability insurance policies targeted at environmental liability such as the Environmental Impairment Liability insurance policy, or "EIL," and the Pollution Liability insurance policy; and 3) the Commercial Property Insurance policy. The first two forms of coverage are known as "third-party" policies, because they cover the insured against liability to a third party. The Commercial Property Insurance policy is known as a "first-party" policy, because it covers the insured against physical loss of or injury to his or her own property.

Liability insurance policies contain either an occurrence⁴² or a claims-made "trigger" of coverage.⁴³ An *Occurrence Policy* provides coverage against liability arising out of injury or damage that occurs during the policy period, regardless of when a claim alleging such liability actually is lodged against the insured. Since occurrence policies may cover liabilities imposed many years after the injury or damage which results in liability occurs, they are said to cover "long-tail" liabilities. Much of the environmental liability insurance litigation that is now in process involves claims for coverage of long-tail liabilities under CGL policies that are decades old. Adjudication of such coverage disputes is a bit like doing astronomy. Just as the light an astronomer observes today may come from a star that ceased to exist long ago, so the claims adjudicated today may arise under standard-form policies whose terms have been revised in more recent editions. But like the light from a long-dead star, the rights of insureds and insurers under older CGL occurrence policies continue to exist.

In contrast to the occurrence policy, a *Claims-Made Policy*

The policy contains no pollution exclusion or other provision that would exclude coverage against such liability.

42. Prior to 1966, the CGL trigger of coverage was bodily injury or property damage caused by "accident." This term was not defined in the policy, but was interpreted in a manner very similar to the current trigger, an "occurrence," which was incorporated in the 1966 revision of the CGL policy. For further discussion of this revision, see Chapter Three.

43. For further discussion of the differences between these kinds of policies, see K. Abraham, *INSURANCE LAW AND REGULATION* 155-56 (1990); *Sparks v. St. Paul Insurance Company*, 100 N.J. 325, 495 A.2d 406 (1985).

provides coverage against liability arising out of claims made during the policy period only.⁴⁴ Most CGL policies figuring in environmental liability insurance disputes have been occurrence policies, whereas most EIL policies contain a claims-made trigger of coverage.

1. *The CGL Policy.*

Without question the CGL policy has been most centrally involved in environmental liability insurance disputes. Before the standard-form policy first came on the market in 1941, different "public liability" insurance policies covered liability for bodily injury and property damage arising out of specified activities: contractors' or owner's and landlord's liability, for example.⁴⁵ The important feature of the CGL, or Comprehensive General Liability insurance policy, was that it provided general coverage regardless of the identity or nature of the insured's business, and even if there was an expansion of the law governing the insured's liabilities; it was (and is) "general" liability insurance coverage. The CGL policy has been frequently revised over the years, with major revisions occurring in 1947, 1955, 1966, 1973, and 1986.⁴⁶ For many years the first portion of the policy was a "jacket" containing general provisions, followed by "Coverage Parts" that contained provisions tailored to particular kinds of businesses—Manufacturers and Contractors, Products and Completed Operations, etc.⁴⁷ This practice has now been discontinued, but even before that time these differences between CGL policies sold to different kinds of businesses were overshadowed by their common feature: in successive versions that have now been marketed for over fifty years, the Insuring Agreement of the CGL policy affords coverage against liability for bodily injury or property damage regardless of the activity out of which the liability arises. For example, a recent version of the CGL, now called the Commercial General Liability insurance policy, provides simply that the insurer:

44. See B. Ostrager and T. Newman, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* §4.02 at 79 (3d ed. 1990).

45. See D. Malecki et al., 1 *COMMERCIAL LIABILITY RISK MANAGEMENT AND INSURANCE* 238 (2d ed. 1986).

46. The latest major revision took place during the years 1984–86; but since this version tended not to be finally approved by state Insurance Commissioners until 1986, I shall refer to it throughout the book as the "1986" CGL policy.

47. See D. Malecki et al., 1 *COMMERCIAL LIABILITY RISK MANAGEMENT AND INSURANCE* 239–42 (2d ed. 1986).

* * * will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. * * *

Thus, any business can purchase a CGL policy and be assured that it has general insurance against liability for physical harm, regardless of the activity or activities in which it engages, subject of course to the Exclusions and Conditions the policy contains.

2. *Special-Purpose Liability Insurance Policies.*

For a little less than a decade during the mid-1970's to mid-1980's, a form of coverage typically called "Environmental Impairment Liability" insurance was readily available.⁴⁸ Because such policies were not written as standard forms their terms varied. Their basic intent, however, was to cover liability for damage caused by "environmental impairment," which often was defined to include

* * * the emission, discharge, dispersal, disposal, seepage, release or escape of any liquid, solid, gaseous or thermal irritant, contaminant or pollutant into or upon land, the atmosphere or any watercourse or body of water, or * * *

* * * the generation of smell, noises, vibrations, light, electricity, radiation, changes in temperature or any other sensory phenomena but not fire or explosion * * *

During roughly the same period that the EIL was marketed, a somewhat more standardized policy that also targeted environmental liability was promulgated by the Insurance Services Office (ISO), the organization through which most property/casualty insurance policies are standardized.⁴⁹ This was titled the "Pollution Liability" insurance policy. The "Pollution Liability" policy insured against liability for damages imposed because of a "pollution incident" resulting in bodily injury or property damage, and defined "pollution incident" to include releases of "solid, liquid, gaseous, or thermal contaminants,

48. See generally Smith, *Environmental Damage Liability Insurance—A Primer*, 39 BUS. LAWYER 333 (1983).

49. For a survey of the coverage that was available during this period, see U.S. Dep't of the Treasury, HAZARDOUS SUBSTANCE LIABILITY INSURANCE (National Technical Information Service, March 1982).

irritants, or pollutants * * *” from an insured site “* * * onto, into, or upon land, the atmosphere; or any watercourse or body of water,” provided that the release resulted in “environmental damage.” The latter term was defined as the injurious presence of the covered pollutant in or upon the above-mentioned areas.

3. *Commercial Property Insurance.*

First-party property insurance provides coverage against physical loss to or destruction of the insured's own property. Many property insurance policies provide “all-risk” coverage.⁵⁰ These policies insure against physical damage to the insured property resulting from any “peril,” or cause, unless the peril is excluded. Commercial property insurance policies often provide “specified-risk” or “named peril” coverage, insuring only against damage resulting from named perils, such as fire, hail, smoke, explosion, windstorm, flood, or vandalism. In addition, many policies contain a provision that covers the cost of the removal of debris from the insured property, provided that it is debris of covered property.

Although neither of these forms of coverage provides liability insurance, in certain situations insureds have argued that they provide coverage that could help to defray the cost of one form of liability under CERCLA, RCRA, and analogous state cleanup regimes. One possible remedy under these regimes involves cleanup of contaminated sites by the owner or operator of the site in response to administrative or judicial order.⁵¹ If the damage caused by the contamination were held to fall within the terms of the basic property coverage or the debris-removal provisions of the site owner's or operator's property insurance policy, then some of the cost of cleanup would in effect be covered by that policy, even though the owner's liability for that cost is not itself covered.

IV. PRINCIPLES OF INSURANCE POLICY INTERPRETATION

Questions regarding the proper interpretation of insurance policy provisions are at the center of almost all environmental liability

50. See generally P. Butler (ed.), *THE ALL RISK POLICY: ITS PROBLEMS, PERILS, AND PRACTICAL APPLICATIONS* (American Bar Association 1986).

51. See, e.g., CERCLA §106(a), 42 U.S.C. §9606(a).

insurance coverage disputes. Indeed, in a very real sense these often are nothing more than disputes over interpretation. The interpretive task may therefore be the single most important feature of any advocate's role and the greatest challenge to any court attempting to decide an environmental liability insurance coverage case. In this Section, I consider the principles of insurance policy interpretation, focusing on two topics that figure prominently in environmental liability insurance litigation. The first topic involves the general question of which canons of construction should apply to the interpretation of insurance policies, and how these canons apply. The second topic concerns the implications for the interpretation of insurance policies of the process by which insurance policies become standardized.

A. The Canons of Construction

To some extent the principles governing the interpretation of insurance policies are the same principles that govern the interpretation of all contracts. For example, absent countervailing considerations such as the demands of public policy, the plain meaning of an insurance policy should be enforced.⁵² Two "canons" of construction, however, are more characteristically employed in disputes over the meaning of insurance policies than in other cases involving the interpretation of contract language. These are the maxim *contra proferentem*, which directs that ambiguities be interpreted against the drafter, and the principle that the reasonable expectations of the insured should be honored, notwithstanding contrary policy language.

1. *Contra Proferentem*.

Perhaps the most prominent rule in all of insurance law is summarized by the maxim, *contra proferentem*, which directs that ambiguities in a legal document be interpreted against its drafter:

There are literally thousands of judicial opinions resolving insurance coverage disputes in favor of claimants on the basis that a provision of the insurance policy at issue was ambiguous and therefore should be construed against the insurer.⁵³

52. See *National Fidelity Life Ins. Co. v. Karaganis*, 811 F.2d 357 (7th Cir. 1987).

53. See R. Keeton and A. Widiss, *INSURANCE LAW* §6.3 at 629 (1988).

A policy provision is ambiguous when it is reasonably susceptible to more than one meaning.⁵⁴ The strongest argument for interpreting ambiguous policy provisions against the drafter is that because the drafter has the power to draft unambiguous language, it should be responsible when a particular provision is ambiguous. Ordinarily the insurer is the drafter, and ambiguities are interpreted in favor of coverage. Thus, although *contra proferentem* is sometimes conceived as a consumer protection device, the maxim also is commonly invoked in disputes between insurers and commercial enterprises.⁵⁵ In addition, the maxim probably also reflects a social policy favoring the spreading of risk through insurance. In cases where the effect of policy language on coverage is uncertain, the maxim directs that coverage be favored. On the other hand, in situations where the insurer and the insured jointly drafted a non-standard policy provision or endorsement, the maxim would seem to be inapplicable; and in the unusual situation in which the insured drafted such a provision, the maxim would seem to direct that the provision be construed against the insured.

The proper limits on use of the maxim also are worth noting, for they are sometimes overlooked. First, the insured is not entitled to have an ambiguous term interpreted in whatever manner that it desires. Rather, if a term may reasonably be interpreted in two ways, the insured is entitled to have the term interpreted in a manner that favors coverage.⁵⁶ Second, terms or phrases that are ambiguous in the abstract may be unambiguous in context. A reading of the entire provision or policy in which an arguably ambiguous term is contained, for example, may render the term unambiguous.⁵⁷

54. See *New Castle County v. Hartford Accid. & Indem. Co.*, 673 F.Supp. 1359 (D.Del. 1987); B. Ostrager and T. Newman, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* §1.02 at 7 (3d ed. 1990).

55. Judge Learned Hand put it somewhat differently: "the canon *contra proferentem* is more rigorously applied in insurance than in other contracts, in recognition of the difference between the parties in their acquaintance with the subject matter." *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599 (2d Cir. 1947), *cert. denied*, 331 U.S. 849 (1947).

56. See R. Keeton and A. Widiss, *INSURANCE LAW* §6.3 at 628 n.4 (1988).

57. See, e.g., *Holland v. Stanley Scrubbing Well Ser.*, 666 F.Supp. 898 (W.D. La. 1987); *Mobark Industries, Inc. v. Western Employers Ins. Co.*, 170 Mich. App.2d 603, 429 N.W.2d 213 (1988).

2. *Honoring the Reasonable Expectations of the Insured.*

The expectations principle is a canon of more recent vintage. Beginning in the nineteen sixties the courts began to honor the objectively reasonable expectations of the insured regarding coverage, notwithstanding contrary policy language.⁵⁸ So formulated, the expectations principle is a potentially more radical interpretive tool, for it requires no ambiguity before it may apply. The courts that have explicitly employed the principle have nonetheless limited its application, although often without expressing the scope of those limitations.⁵⁹ Without question the most significant limitation is contained in the statement of the principle itself: an expectation of coverage must be "objectively" reasonable in order to take precedence over unambiguous policy language. Such an expectation may be objectively reasonable because most people in the insured's position would share it,⁶⁰ because other language in the policy would lead a reasonable person to that expectation, or because an action or statement by the insurer created the expectation. Most often the principle has been employed in such situations as a consumer protection device to guard against the unfair use of fine-print limitations on coverage, although the principle has been employed in commercial insurance disputes as well.⁶¹ The expectations principle sometimes also has been employed by name in order to assist in the interpretation of an ambiguous term. Use of the expectations principle in this situation is a method of pouring content into the maxim *contra proferentem*.⁶² Here the principle limits the range of possible interpretations of ambiguous terms or phrases to those producing coverage that the insured would reasonably expect to be provided by the policy in question.

58. For discussion of the emergence of the expectations principle, see R. Keeton and A. Widiss, *INSURANCE LAW* §6.3 at 628-34 (1988).

59. Analysis of these limitations on the principle, both explicit and implicit, is undertaken in K. Abraham, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 101-32 (1986); Henderson, *The Doctrine of Reasonable Expectations After Two Decades*, 51 Ohio St. L.J. 823 (1990).

60. See, e.g., *Keene Corp. v. Ins. Co. of North America*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982).

61. See, e.g., *id.*

62. See Henderson, *The Doctrine of Reasonable Expectations After Two Decades*, 51 Ohio St. L.J. 823, 826 (1990).

3. *The Other Canons of Construction.*

Contra proferentem and the expectations principle are only two of the many canons of construction that are employed in the interpretation of insurance policies. The other important canons are that the policy language providing coverage should be interpreted broadly,⁶³ and that language limiting or excluding coverage should be interpreted narrowly.⁶⁴ Aside from the canons that have particular significance for the interpretation of insurance policies, however, the courts tend to follow the standard rules governing the interpretation of contracts when they interpret insurance policies. For example, the traditional rule is that extrinsic evidence is not admissible to aid in the construction of unambiguous contract language,⁶⁵ but the modern approach of provisionally admitting extrinsic evidence in order to demonstrate that a contract term or phrase is in fact ambiguous⁶⁶ is sometimes followed in insurance contract disputes.⁶⁷ One area of particular controversy concerns the proper relation between the special principles of insurance policy interpretation, such as *contra proferentem* and the expectations principle, and the more general canons of contract construction. The general canons of construction resort to a hierarchy of interpretive aids in the face of contractual ambiguity—the course of actual performance is first consulted; if the actual performance does not resolve the ambiguity, then the course of dealing is consulted; finally, if that course of dealing does not resolve the ambiguity, then the usage of the trade is consulted.⁶⁸ Some commentators have argued that these general canons should take

63. See, e.g., *Uniroyal, Inc. v. Home Ins. Co.*, 707 F.Supp. 1368 (E.D. N.Y. 1988); *Avondale Industries, Inc. v. Travelers Indem. Co.*, 887 F.2d 1200 (2d Cir. 1989).

64. See COUCH ON INSURANCE 2D §§15:48, 15:93 (rev. ed. 1984).

65. See B. Ostrager and T. Newman, HANDBOOK ON INSURANCE COVERAGE DISPUTES §1.01 at 5 (3d ed. 1990).

66. See, e.g., *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal.2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968); *Restatement (Second) of Contracts* §212, Comment (b).

67. See, e.g., *Trident Center v. Connecticut Gen. Life Ins. Co.*, 847 F.2d 564 (9th Cir. 1988); *Garcia v. Truck Ins. Exchange*, 36 Cal.3d 426, 682 P.2d 1100, 204 Cal. Rptr. 435 (1984).

68. See Uniform Commercial Code §§2-208(2), 1-205(4); *In re Asbestos Insurance Coverage Cases*, Judicial Council Coordination Proceeding No. 1072, Statement of Decision Concerning Phase III Issues, slip. op. at 39-40 (Cal. Super. Ct. San Francisco Cty. Jan. 24, 1990).

precedence over the special principles of insurance policy interpretation, the latter being employed only as a last resort, as tiebreakers.⁶⁹ In one sense the question here is what purpose lies behind the special principles of insurance policy interpretation. To the extent that these principles reflect a public policy that favors the broad spreading of loss through insurance, then the special principles should take precedence over the general canons. In contrast, to the extent that the special principles are simply devices for regulating the process by which insurance language is formulated, the general canons should take precedence. Obviously, there is an element of both purposes in the special principles of insurance policy interpretation; the degree to which one or the other purpose is felt to be important in a particular setting is likely to be a greater influence on the approach adopted than an abstract rule governing the issue.

In another sense, however, it might be argued that the issue is somewhat beside the point, at least in most environmental liability insurance disputes. Interpretation in the face of ambiguity is not a mechanical process. Rather, properly conducted interpretation involves the tentative testing of alternative constructions of ambiguous language in light of the entire context of any dispute. Interpretation is an "all things considered" exercise, not a process of assuming "other things being equal" when they are not. For example, when the course of dealing between an insurer and insured makes it clear that their practical interpretation of an ambiguous policy provision was that the provision did or did not cover certain claims, that is likely to be powerful evidence. The same might be true of trade custom evidence under some circumstances. Often these forms of evidence will not be powerful, however, and a court willing to consider them will have to resort to an overall assessment of the meaning of the policy provision in question, rather than to a hard-and-fast rule regarding hierarchies of evidence.

But even powerful evidence of the parties' course of dealing or of trade custom might in some cases have to be weighed against two other factors. The first factor involves the legal policies that lie behind the doctrines of waiver and estoppel, and the limits of those

69. See, e.g., B. Ostrager and T. Newman, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* §1.01 at 7 (3d ed. 1990). See also Note, *Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine*, 88 COLUM. L. REV. 1849 (1988).

doctrines.⁷⁰ For example, to hold that the parties' course of dealing creates a binding interpretation of a policy even when the requisites of waiver or estoppel are not satisfied would undermine the purposes of the limits on those doctrines.⁷¹ An insured may forego making a class of claims that the insurer has denied in the past without intending to waive its right to make similar claims involving much larger sums in the future; and an insurer may pay claims that it believes are not in fact covered as a courtesy to the insured or because their nuisance value warrants payment. A general rule that such conduct creates a binding interpretation of the policy language in question would ignore the context in which the course of dealing between the parties has taken place.⁷² The second factor hinges on the value of standardized meaning in the insurance field. For reasons I shall address in the following Section, both insurers and insureds depend heavily on the availability of standard insurance coverage. Canons of construction that resort to course of dealing or localized trade custom as aids to the interpretation of ambiguous policy language threaten to undermine the uniformity of meaning of identical insurance policies. In contrast, precisely because they depend on the objective reasonableness of proposed interpretations of ambiguous language, the special principles of insurance policy interpretation have the potential to encourage rather than to undermine uniformity.

This is not to say that the general canons of contract construction are out of place in insurance disputes. These canons do have a place, but it can be argued that their place is alongside the special principles of insurance policy interpretation, not ahead of or behind those principles. Any other formulation would either be out of touch with

70. See R. Keeton and A. Widiss, *INSURANCE LAW* §6.1 at 617-18 (1988).

71. In addition, both the 1966 and 1973 standard-form CGL policies—though apparently not the 1986 policy—contain a condition labelled "Changes" that may affect the availability of waiver and estoppel claims. In the 1973 policy this provision reads, "* * * nor shall the terms of this policy be waived or changed except by endorsement issued to form a part of this policy." Of course, two questions remain even when this provision would otherwise seem to be applicable. First, to what extent is a particular policy provision being "interpreted," as distinguished from being "changed" through application of the doctrines of waiver and estoppel? Second, to what extent might the doctrines of waiver and estoppel override the "Changes" provision and result in a ruling that this provision itself had been waived, or that one of the parties was estopped to assert it?

72. See, e.g., *Uniroyal, Inc. v. Home Ins. Co.*, 707 F.Supp. 1368 (E.D.N.Y. 1988); *Cargill, Inc. v. Liberty Mut. Ins. Co.*, 488 F.Supp. 49 (D.Minn. 1979).

reality or lacking in candor, for interpretation of ambiguous policy language in multi-million dollar environmental liability insurance disputes inevitably should and does reach out for all available assistance in arriving at a responsible reading of the policy provisions at issue.

B. The Standardization Process

I suggested in the preceding Section that one factor the courts do and should consider in the course of interpreting ambiguous policy language involves the value of standardized coverage. Most of the insurance policies that figure in environmental liability insurance disputes are standard forms. For this reason it is useful to understand how policies become standardized, the functions performed by standardization, and the implications of standardization for environmental liability insurance coverage disputes.

1. *How Standardization Occurs*

Liability insurance policies become standardized in either of two ways. The first is by operation of law. For example, occasionally the terms of entire insurance policies or of particular provisions are prescribed by statute. In other situations the terms or substance of particular provisions are prescribed by administrative regulations issued by state Insurance Commissioners.⁷³ And even aside from the processes by which policy provisions are formally prescribed by statute or administrative regulation, Insurance Commissioners can influence the degree to which policies are standardized by exercising their authority to approve or disapprove the terms of particular policies. In each of these ways statutory and regulatory action can require or promote standardization.

The second and by far the dominant method by which insurance policies become standardized, however, is through insurance industry practices. Standardization of liability insurance policies through such practices began late in the nineteenth century. One of the first insurer organizations to engage in standardization was the National Bureau of Casualty Underwriters (NBCU), an organization of stock companies

73. See R. Keeton and A. Widiss, INSURANCE LAW §2.8 at 121-24 (1988).

formed in 1896; eventually it changed its name to the Insurance Rating Board (IRB). Mutual insurance companies formed their own organization, the American Mutual Alliance, some of whose functions were later transferred to the Mutual Insurance Rating Bureau (MIRB). The IRB and the MIRB (and a number of other organizations) merged in 1971 to form the Insurance Services Office (ISO), which is still in operation.

ISO's members consist exclusively of insurance companies. ISO drafts, promulgates, and (where permitted) files entire policies or separate endorsements to entire policies on behalf of individual companies for approval by state Insurance Commissioners.⁷⁴ Sometimes a particular policy or endorsement originates in ISO. Frequently, however, such policies or endorsements emerge in the market itself, different companies experiment with different versions, and as demand for the coverage provided by these different instruments becomes recognized ISO enters the process and promulgates a standard form. ISO's members and subscribers are not required to employ ISO's standard policies, but the advantages of doing so are considerable. Thus, through their participation in ISO, individual companies can debate the advantages and disadvantages of particular approaches, and can then decide whether to market standard policies or to seek regulatory approval of non-standard policies or policy provisions.

2. *The Functions of Standardization*

Standardization performs a number of functions. First, standardization allows insurance purchasers to engage in comparison price shopping. In the ordinary situation a potential purchaser need only shop for price, because the terms of coverage do not vary, for example, from CGL policy to CGL policy. Second, and consequently, by eliminating or at least vastly reducing this potential variation in the terms of policies marketed by different companies, standardization helps to assure potential purchasers of the quality of the product in question, since each policy of a particular type provides the same coverage. Of course, the quality of service provided and the financial

74. For more detailed discussion, see Insurance Services Office, INSURANCE SERVICES OFFICE IN A COMPETITIVE MARKETPLACE: ISO'S ROLE WITHIN THE PROPERTY CASUALTY INDUSTRY (June 1987).

stability of insurers are also important to policyholders, but standardization of coverage also allows these factors to be assessed without the assessment being complicated by differences in the coverage afforded by different insurers.

Finally, standardization makes it possible for ISO to perform its other major function for property/casualty insurers—collection and maintenance of data on claims and loss experience under different kinds of policies, and the projection of future losses under these policies. If such data were not available, then each company would have to prepare rates based on statistically less reliable data regarding claims and losses under its policies alone. Moreover, without standardized policies, the collection and maintenance of this industry-wide claim and loss data would be pointless, for the claims and losses reported would be against policies providing non-identical coverage.⁷⁵ In the past ISO has actually prepared advisory rates based on that data. Although that function is now being discontinued,⁷⁶ the availability of aggregate data on claims and losses under standard policies still can facilitate the preparation of rates by individual companies by providing a statistically reliable base of information to use in calculating premium rates.⁷⁷

In describing the functions of standardization, I do not mean to suggest that standardization has only positive effects. There is in fact considerable debate about the virtues of standardization. For example, although standardization makes meaningful price comparison possible, it severely restricts the possibility of shopping for insurance products whose terms might otherwise vary from company to company. In effect, standardization facilitates price competition by impeding competition over the terms of coverage.⁷⁸ In addition, ISO not only aggregates raw data on claims and losses but also “develops” and “trends” that data (the technical terms for extrapolating from incomplete data to make predictions about what complete data would

75. For further discussion of this point, see K. Abraham, *INSURANCE LAW AND REGULATION* 33 (1990).

76. See Insurance Services Office, *USING THE PAST TO PREDICT THE FUTURE: HISTORICAL DATA, LOSS DEVELOPMENT, AND TREND* (1989).

77. See K. Abraham, *INSURANCE LAW AND REGULATION* 180–81 (1990).

78. See *id.* at 33.

show and to project future losses).⁷⁹ As a consequence, there may be less price competition than might otherwise be expected within a comparatively unconcentrated industry such as the property/casualty insurance business. For these and other reasons there is considerable ferment at both the state and federal levels about the process of standardization and about the proper legal treatment of the process.⁸⁰

C. The Implications of Standardization for Coverage Disputes

The major insurance policy involved in environment liability insurance coverage disputes—the CGL policy—has been fully standardized since 1941. Similarly, the EIL and Pollution Liability insurance policies of the 1970's and 1980's were reasonably standard, although the terms of the former varied somewhat from policy to policy. The fact that these were standard-form policies has two major implications for such coverage disputes. The first issue involves the use of drafting history in such disputes; the second involves disputes in which the insured is a sophisticated business rather than an individual consumer.

1. *Drafting History.*

Because there is sometimes recorded history about the deliberations and intentions of those who drafted successive versions of standard policies over the years, the relevance of that history to the meaning of particular coverage provisions has often become an issue in environmental insurance coverage disputes. On the one hand, it is black-letter contract law that parol evidence of the parties' intentions is not admissible to prove the meaning of a contract term unless that

79. See Insurance Services Office, *USING THE PAST TO PREDICT THE FUTURE: HISTORICAL DATA, LOSS DEVELOPMENT, AND TREND* (1989).

80. The McCarran-Ferguson Act, 15 U.S.C. §§1011–15, provides a limited exemption for “the business of insurance” from the reach of the federal antitrust laws. For discussion of the scope of this exemption, see K. Abraham, *INSURANCE LAW AND REGULATION* 139–81 (1990). The most prominent recent case involving the scope of the exemption is *In Re Insurance Antitrust Litigation*, 723 F. Supp. 464 (N.D. Cal. 1989), *rev'd*, ____ F.2d ____ (9th Cir. 1991). In that case the court granted summary judgment for the defendants in a suit by nineteen states, alleging Sherman Act violations in connection with the drafting of standard CGL policy revisions by the Insurance Services Office and designated primary insurers, reinsurers, and insurance intermediaries.

individuals in the course of such deliberations do not necessarily reflect the view of the group as whole; such statements are analogous to positions taken about the meaning of proposed legislation by individual legislators. Like legislative history,⁸⁶ however, although such statements are not automatically determinative of the meaning of a policy provision, in particular contexts they may shed light on that meaning and may therefore be relevant. Moreover, when the issue is how to interpret an ambiguous policy provision, if the interpretation proposed by the insured came from the mouth of the drafter of the provision, ordinarily this would be some evidence that the proposed interpretation is reasonable.

The argument for admitting at least certain forms of post-promulgation evidence is stronger. Typically the organization that has promulgated a standard-form policy (usually ISO) then files the policy for approval by the Insurance Commissioners in the states where the policy is to be marketed. Explanatory statements made in support of the application for approval are not those of an individual in the course of a deliberative drafting process, but of an agent of all the insurance companies who subsequently issue the policy or endorsement in question. The most celebrated example of such a statement involves the filing of the "pollution exclusion" with various state Insurance Commissioners in 1970.⁸⁷ In such a setting statements by an insurance industry agent interpreting or clarifying the meaning of particular insurance policy provisions might resemble Committee Reports in the legislative setting. That is, such statements might be taken to state a collective judgment by the drafters that is not binding but is highly indicative of the intentions of many of those who vote in favor of the legislation, although the precise setting in which the statements were made and the scope of authority of their maker would also seem relevant. In any event, where the policyholder's burden is merely to show that its interpretation of an ambiguous provision is but one reasonable interpretation, evidence that the interpretation

86. See F. R. Dickerson, *THE INTERPRETATION AND APPLICATION OF STATUTES* 137-68 (1975).

87. See, e.g., *Claussen v. Aetna Cas. & Sur. Co.*, 676 F. Supp. 1571 (S.D. Ga. 1987). This history is discussed in my analysis of the pollution exclusion in Chapter Four. See also Greenlaw, *The CGL Policy and the Pollution Exclusion Clause: Using the Drafting History to Raise Interpretation Out of the Quagmire*, 23 COLUM. J. OF LAW AND SOC. PROBLEMS 233 (1990).

subscribed to by at least some of the drafters was the same as or similar to the policyholder's proposed interpretation would seem relevant.

Sometimes an explanatory statement actually appears to have been relied upon by an Insurance Commissioner in approving the policy whose terms are explained. Under such circumstances it can be argued that the statement should be taken not as mere evidence of the intentions of the drafters of the policy, but as a condition of approval. If this were the case, then the statement could be more than evidence—it could be binding on the insurers issuing the policy. Since more typically an explanatory statement is merely one factor in the decision to approve a particular policy or provision, however, such statements normally would at most be relevant to but not dispositive of the meaning of the policy or provision in question.

2. *The Sophisticated Insured.*

Is there implicit in the very concept of the standard-form insurance policy the idea that such a policy has a uniform meaning? In one sense this question must be answered in the affirmative, for the central purpose of standard-form policies requires that they have a uniform meaning. On the other hand, it is fairly clear that a number of the special principles of insurance contract interpretation—most prominently, *contra proferentem* and the expectations principle—have received their most forceful application in disputes involving comparatively unsophisticated consumers. It might be argued, therefore, that these principles should be inapplicable in environmental liability insurance disputes, because the insureds in these disputes tend to be sophisticated businesses rather than unsophisticated individuals.⁸⁸ Unsophisticated insureds would then be permitted to take greater advantage of the special principles of insurance policy interpretation than sophisticated insureds. The result would be that the same standard-form policy might sometimes have two different meanings depending on the status of the party insured.

In a different sense, however, the idea that this issue should turn on whether an insured is “sophisticated” may be problematic. First, in

88. See, e.g., *McNeilab, Inc. v. North River Ins. Co.*, 645 F.Supp. 525 (D.N.J. 1986); B. Ostrager and T. Newman, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* §1.02 at 22–32 (3d ed. 1990).

some instances the insured may be able to show that it had no realistic choice about the terms of the insurance policies it purchased, for its insurer was willing to issue a standard-form policy or none at all. It can be argued that under such circumstances it is irrelevant whether the insured is a large or sophisticated business. On the other hand, where the insured actually participated in the drafting of a non-standard provision or modification of a standard provision, the argument for invoking the maxim *contra proferentem* seems very weak, whether or not the insured is "sophisticated." Second, the crucial question may not be whether the insured is sophisticated, but whether its particular understanding of a policy provision should be relevant. Evidence of the insured's subjective understanding of the meaning of a policy provision is more likely to be available in cases involving business insureds than individuals, but only more likely. The issue is whether to adhere to principles of interpretation that ignore such evidence in the interest of ensuring that standard-form insurance policies have as nearly a uniform meaning as possible.⁸⁹ In certain situations this dilemma can be sidestepped. For example, even a sophisticated insured may have a clear expectation that it has purchased a standard-form policy precisely in order to obtain whatever coverage the courts hold is provided by the policy. There is no real conflict in this situation between the idea that standard-form policies have a uniform meaning and the existence of sophisticated insureds.

In other situations, however, this dilemma cannot be so easily resolved or avoided. Suppose that the head of an insured's risk-management department understood at some time in the past that its CGL insurance policy or policies did not cover the cost of complying with regulatory or injunctive orders. Evidence from which a jury might be permitted to infer the existence of such an understanding might come from express statements to that effect, from a course of conduct indicating the understanding, or from the insured's decision not purchase other coverage intended to insure against such costs and to self-insure against this risk instead.⁹⁰

89. The difficulty of ensuring uniform meaning even when no distinction is drawn between sophisticated and unsophisticated insureds is noted in K. Abraham, *INSURANCE LAW AND REGULATION* 31-33 (1990).

90. For an example of the latter form of evidence, see *Diamond Shamrock Chem. Co. v. Aetna Cas. & Sur. Co.*, No. C-39-39-84 slip. op. at 28 (N.J. Super. Ct., Ch. Div. Morris Cty. Apr. 12, 1989).

Suppose further that some courts subsequently hold that the standard-form CGL does cover these costs. Is the insured now covered under the previously-issued policy?

The argument for coverage is not only that the ideal of uniform meaning requires that all insureds be afforded the same coverage under identical policies, although this argument itself has its appeal, especially when the insured did not have a choice about whether to purchase standard-form coverage. In addition, for reasons to be discussed in Chapter Three, environmental liability insurance disputes often involve policies issued a dozen or more years before the dispute is litigated. An interpretive strategy that automatically places at issue the states-of-mind of employees or officers of a corporate enterprise at some time in the distant past may create extended discovery, very difficult problems of proof for the parties, and fact-finding nightmares for the courts. An objective rule of interpretation that disregarded a sophisticated insured's subjective understanding of the meaning of standard-form policy provisions would avoid these difficulties.

But an objective approach to interpretation would create other difficulties. The principal difficulty is that such an approach would make it very difficult for sophisticated insureds and their insurers to be certain of the scope of coverage provided by standard policies, since that scope would always be subject to enlargement by judicial decisions involving the language in policies purchased by individuals. In theory this problem could be remedied by special written endorsements clarifying the meaning of particular provisions. But unless the parties expected that a particular provision would be subject to later judicial enlargement by decisions involving other insureds, there would be no reason to attach such an endorsement to a policy. Thus, for practical purposes there would be no way to assure that the policy would continue to mean what both parties intended it to mean. As a result, insurers would have to set higher premiums for sophisticated insureds than would be necessary if evidence of such insureds' subjective understanding that they were not covered against particular forms of liability were admissible to prove the meaning of standard-form policy language.

In summary, the existence of standard-form policies may pose a real dilemma in certain cases involving sophisticated insureds. On the one hand, the ideal of uniform meaning argues in favor of an objective approach that makes individual understandings of the scope of

coverage irrelevant unless they are incorporated in the policy by written endorsement. Moreover, in many instances the sophisticated insured will have purchased a standard-form policy on the assumption that it was getting standard-form coverage, regardless of any understanding it had about the meaning of particular provisions. On the other hand, such an approach sometimes would contradict the parties' actual understanding of the meaning of their agreement, and might unnecessarily raise the cost of insurance for sophisticated insureds. A court that values uniformity of meaning must be willing to tolerate these latter disadvantages in adopting an objective approach; yet a court that rejects the objective approach and considers subjective understandings must recognize that it is undermining the uniformity of meaning of standard-form policy provisions.