

1994

## The Duty to Defend in California After *Montrose Chemical Corporation v. Superior Court*: Is the California Supreme Court Protecting Policyholders or Encouraging Litigation and the Early Settlement of Unworthy Claims?

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### Recommended Citation

Harrington, Paula L. (1994) "The Duty to Defend in California After *Montrose Chemical Corporation v. Superior Court*: Is the California Supreme Court Protecting Policyholders or Encouraging Litigation and the Early Settlement of Unworthy Claims?," *California Western Law Review*. Vol. 31 : No. 1 , Article 9. Available at: <https://scholarlycommons.law.cwsl.edu/cwlr/vol31/iss1/9>

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NOTE, THE DUTY TO DEFEND IN CALIFORNIA AFTER  
*Montrose Chemical Corporation v. Superior Court*:  
IS THE CALIFORNIA SUPREME COURT PROTECTING  
POLICYHOLDERS OR ENCOURAGING LITIGATION AND THE EARLY  
SETTLEMENT OF UNWORTHY CLAIMS?

INTRODUCTION

When the California Supreme Court rendered its unanimous decision in *Montrose Chemical Corp. v. Superior Court*,<sup>1</sup> on November 22, 1993, the insurance industry and attorneys who represent policyholders publicly proclaimed its significance. While the attorney for Montrose Chemical Corporation declared the decision “a sweeping victory” for policyholders, an insurance industry attorney called the decision “a damaging blow” to the insurance industry and “the most significant insurance case in twenty-five years.”<sup>2</sup> Some observers believe the case will be used as a guide by courts in other states.<sup>3</sup>

An attorney involved in *Montrose* said, “the duty to defend permeates every [liability]<sup>4</sup> insurance contract issued in California.”<sup>5</sup> For example, in recent standard policy language, liability insurers promised to “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.”<sup>6</sup> Along with this promise, liability insurers typically reserve “the right and duty to defend any ‘suit’ seeking those damages.”<sup>7</sup> Whenever a policy contains this or similar language and the policyholder is sued by a third party, the question arises whether the insurer has a duty to pay the costs of the policyholder’s defense. This is commonly referred to as the insurer’s “duty to defend.”<sup>8</sup>

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1. 861 P.2d 1153 (Cal. 1993).

2. Alfred G. Haggerty, *California Insurers Lose Challenge on Defense Costs*, NAT’L UNDERWRITER, Dec. 13, 1993, at 4.

3. Judy Greenwald, *Insurers Must Defend If ‘Potential’ for Coverage Exists; Court Expands Duty to Defend*, BUS. INS., Nov. 29, 1993, at 2.

4. Liability insurance policies are different from first party insurance contracts, which pay benefits directly to the insured. In the usual first party insurance contract, the insurer agrees to pay the insured on the happening of a certain event covered under the terms of the policy. Health, life, disability, and accident insurance are common examples of first party insurance contracts. In a liability insurance policy, an insurer agrees to indemnify the insured against claims asserted by third parties. The most common types of third party policies include automobile liability, professional liability, homeowner’s liability, and comprehensive general liability. ROBERT C. CLIFFORD, CALIFORNIA INSURANCE DISPUTES, §§ 9.02C, 10.02 (1994).

5. Haggerty, *supra* note 2, at 1.

6. MITCHELL L. LATHROP, INSURANCE COVERAGE FOR ENVIRONMENTAL CLAIMS, § 3.01[2] (1994).

7. *Id.* (emphasis added).

8. *See, e.g., id.* § 8.03.

An insurance coverage dispute may develop whenever an insurer refuses to provide a policyholder with a defense based on an assertion that the third party's claims are not covered under the policy.<sup>9</sup> The insurer and its policyholder may then seek to litigate their disagreement over the insurer's alleged duty to defend in an action for declaratory relief.<sup>10</sup> In *Montrose*, the California Supreme Court not only resolved such a dispute in favor of Montrose as the policyholder, but also pronounced new procedural rules to be applied when a policyholder seeks to establish a duty to defend in a motion for summary judgment or adjudication<sup>11</sup> before trial.<sup>12</sup>

On the surface, these new procedural rules do represent a "sweeping victory"<sup>13</sup> for policyholders because, under certain circumstances, they make it relatively simple for a policyholder to establish an insurer's duty to defend by filing an early motion for summary adjudication.<sup>14</sup> At the same time, the California Supreme Court's decision in *Montrose* makes it much more difficult for an insurer to be relieved of its duty to defend, even where the facts learned from all sources strongly indicate that the insurer owes no defense. As a result, the California Supreme Court's pronouncement in *Montrose* of new rules governing the duty to defend is important to policyholders as well as to insurance companies.

This Note will examine these new rules and the effect they will have on insurance law in California. Section I surveys the history of the duty to

9. See, e.g., *Montrose*, 861 P.2d at 1155-56.

10. *Id.* See also CAL. CIV. PROC. CODE § 1060 (West 1994):

Any person interested under a . . . contract . . . may, in cases of actual controversy relating to the legal rights and duties of the respective parties, bring an original action or cross-complaint in the superior court . . . for a declaration of his rights and duties in the . . . validity under such instrument or contract. He may ask for a declaration of rights or duties, either or alone or with other relief; and the court may make a binding declaration of such rights or duties, whether or not further relief is or could be claimed at the time. The declaration may be either affirmative or negative in form and effect, and such declaration shall have the force of a final judgment. Such declaration may be had before there has been any breach of the obligation in respect to which said declaration is sought.

11. CAL. CIV. PROC. CODE § 437c(f):

(1) A party may move for summary adjudication as to one or more causes of action within an action, one or more affirmative defenses, one or more claims for damages, or one or more issues of duty, if that party contends that the cause of action has no merit or that there is no affirmative defense thereto, or that there is no merit to an affirmative defense as to any cause of action, or both. . . . A motion for summary adjudication shall be granted only if it completely disposes of a cause of action, an affirmative defense, a claim for damages, or an issue of duty. (2) A motion for summary adjudication . . . shall proceed in all procedural respects as a motion for summary judgment. . . .

12. *Montrose*, 861 P.2d at 1159-64.

13. Haggerty, *supra* note 2, at 4.

14. The only exception to the overall pro-policyholder tone of the opinion is the court's holding that extrinsic evidence can be used to establish as well as negate coverage and/or the duty to defend. *Montrose*, 861 P.2d at 1159-60. This part of the holding represents at least a minor victory for insurers since it dismisses an argument commonly advanced by policyholders that evidence extrinsic to the complaint cannot be used to negate coverage or the duty to defend. Greenwald, *supra* note 3, at 2.

defend that is contained in many liability insurance policies and how it has generally been treated by the courts. Section II outlines the pertinent facts and holdings of *Montrose*. Section III examines the *Montrose* decision to demonstrate its bias in favor of policyholders. The conclusion suggests that a victory for Montrose is not necessarily a victory for all policyholders.

## I. BACKGROUND

A comprehensive general<sup>15</sup> liability ("CGL")<sup>16</sup> insurance policy typically obligates an insurance company to indemnify a policyholder "for all losses covered by the policy up to the policy limits" and to defend the insured "should the insured be sued for any claim covered by the policy."<sup>17</sup> A liability insurer will be inclined to deny the duty to defend and/or indemnify a policyholder whenever the insurer has reason to believe that: (1) the claims alleged fall outside the coverage<sup>18</sup> provided by the policy; (2) the

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15. One author has defined a "general" liability insurance as follows:

The word "general" in the context of general liability insurance means that the policy covers third party liability which is not covered by specific liability insurance, such as automobile, professional liability or other types of specific liability coverages. This does not mean, however, that general liability coverage is limitless or all-encompassing. Each insurance contract, including general liability policies, must be examined in order to determine exactly what coverage is provided.

LATHROP, *supra* note 6, at § 3.01[1][a].

16. One commentator describes "CGL" as follows:

CGL insurance . . . is intended to insure an individual or a company under specified conditions against legal liability to third parties. Most typically, it insures a person or a company against tort claims by others . . . . CGL insurance is to be distinguished from first party insurance. First party insurance insures an individual or company not against the liability of a third party, but for perils relating directly to the insured . . . . CGL insurance is also to be distinguished from named perils coverage. Rather than insuring against all legal liabilities from third parties, named perils coverage insures against specified types of risks, such as fire, explosion or lightning.

Vito A. Peraino, *How to Analyze a CGL Policy or Unreasonable Expectations: The Inapplicability of the Rules of Contra Proferentem to Business Insurance*, in ENVIRONMENTAL AND TOXIC TORT CLAIMS INSURANCE COVERAGE IN 1990 AND BEYOND, 457-58 (PLI Com. Law and Practice Course Handbook Series No. 536, 1990).

17. James M. Fischer, *Broadening the Insurer's Duty to Defend: How Gray v. Zurich Insurance Co. Transformed Liability Insurance Into Litigation Insurance*, 25 U.C. DAVIS L. REV. 141 (1991).

18. The grant of coverage (also referred to as the basic coverage provisions or the insuring agreement):

delineates the nature of the protection afforded and the circumstances under which payment will be made. Terms in the grant of coverage are frequently defined in the 'definitions' section of the policy. In the most recent standardized CGL form, there are three coverage sections, Coverage A—Bodily Injury and Property Damage Liability; Coverage B—Personal Injury and Advertising Injury Liability; and Coverage C—Medical Payments.

LATHROP, *supra* note 6, § 3.01[2][b]. See, e.g., *Royal Globe Ins. Co. v. Whitaker*, 226 Cal. Rptr. 435 (Ct. App. 1986) (The third party claimant made a promise that he did not intend to keep. More specifically, the complaint alleged that the third party claimant suffered injury as a proximate result of the insured's fraud and deceit. *Id.* at 436. Basic coverage provisions in

insured fails to comply with a condition<sup>19</sup> of coverage; or (3) the claims asserted fall within an exclusion<sup>20</sup> in the policy.

In the beginning of this century, when liability policies first came into use, insurers had no affirmative duty to defend. Instead, language included in liability policies merely allowed the insurer to protect its own financial interest by providing the insurer with a "right" to assume control of the defense of the underlying claim "for its benefit."<sup>21</sup> An "economically rational insurer" would exercise its right to assume control of the insured's defense when it believed there was a high probability that a third party's claims would fall within coverage.<sup>22</sup> Over time, the insurer's "right" to defend was transformed into a "duty" by court decisions that made it increasingly more risky for an insurer to refuse to provide a defense.<sup>23</sup> For example, courts generally held that if an insurer refused to defend, it was

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the insured's policy only promised to indemnify or defend claims caused by an accident resulting in bodily injury neither expected nor intended by the insured. *Id.* at 435, 437. The court found that there were no facts indicating unintentional conduct on the part of the insured and that the third party's complaint contained no potential claim for unintentional or accidental conduct. Therefore, the court concluded there was no potential for liability under the policy. *Id.* at 437-38.)

19. "Most commonly found within the conditions section of general liability policies are clauses concerning when notice of a loss must be given to the insurer, and what occurs when there is other insurance covering the loss or 'other insurance' clauses." LATHROP, *supra* note 6, at § 3.01[2][c]. *See, e.g.,* Joyce v. United Ins. Co., 21 Cal. Rptr. 361, 366 (1962) (A notice provision in an insurance policy may operate as a condition of coverage by requiring that an insured provide the insurer with notice of a claim "as soon as practicable, promptly, immediately, or in similar language." *Id.* at 366. However, a delay or failure to give notice is not a defense to coverage unless the insurer can demonstrate substantial prejudice. *Id.* Substantial prejudice exists when an insurer is denied sufficient opportunity to investigate a claim. *Id.* at 367.)

20. "Exclusions are the portion of the policy where the insurer defines that which it is not covering. Typically, CGL policies contain exclusions relating to pollution, intentional acts, owned property, property in the care, custody or control of the insured . . ." Peraino, *supra* note 15, at 462. *See, e.g.,* Fire Ins. Exchange v. Jiminez, 229 Cal. Rptr. 83 (Ct. App. 1986) (The third party claimant alleged an injury that took place on the insured's business premises. *Id.* at 84. The insured sought a defense under his homeowner's policy, which excluded coverage for business pursuits. The court held there was no duty to defend because undisputed facts indicated the injury occurred on the insured's business premises, which were excluded from coverage. *Id.* at 86.). *See also* Dan L. Goldwasser, *Key Policy Sections and Provisions, in* INTRODUCTION TO BUSINESS INSURANCE LAW AND LITIGATION, at 349-50 (PLI Litig. and Admin. Practice Course Handbook Series No. 296, 1985):

[T]here may be one or more classes of risks which the insurer may not wish to cover (i) because those risks may present an unusually large liability exposure, (ii) because insuring such risks may be against public policy or (iii) because the right is peculiarly within the control of the insured making them altogether inappropriate for coverage by insurance. . . . The actual types of risks that will be excluded will primarily depend upon the type of insurance protection being afforded under the policy . . . Of all the terms in an insurance policy, the exclusions tend to be among the more negotiable and the same class of insurance policies written by different insurance companies are likely to have significant differences in their exclusion clauses.

21. Fischer, *supra* note 17, at 147.

22. *Id.* at 178.

23. *Id.* at 148-49.

barred from relitigating facts established in the underlying action and was bound by a judgment rendered in its absence.<sup>24</sup>

In general, courts have resolved duty to defend issues in favor of the insured based on public policy rather than on the “private rules expressed in the contract entered into by the parties.”<sup>25</sup> That is, the duty to defend has been interpreted broadly to require that an insurer “defend against claims it has not contractually agreed to cover because of the potential that claims the insurer *has* agreed to cover may be asserted against the insured.”<sup>26</sup> A decision whether to defend is usually made prospectively by the insurer at the outset of litigation between its insured and a third party. At this time, both parties are in “the worst position to forecast, much less determine, what the facts regarding coverage will eventually be found to be.”<sup>27</sup> Consequently, courts typically impose a duty to defend on the insurer because the insured purchased a liability policy that includes a duty to defend covered claims, and it is difficult to determine at the outset of litigation whether a third party’s claims will fall within coverage once the underlying action is resolved.<sup>28</sup>

Since harsh consequences result from an improper refusal to defend or indemnify,<sup>29</sup> an insurer may resort to filing a separate action for declaratory relief so that a court can determine the obligations of the parties under the policy.<sup>30</sup> A policyholder that believes its insurer has wrongfully refused to defend can also file an action for declaratory relief.<sup>31</sup> Either party may file such an action while the third party’s suit is pending or after its completion.<sup>32</sup> If an insurer refuses to defend and then files an action for declaratory relief, the insured is forced to “wage a two-front war”<sup>33</sup> by defending

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24. *Id.*

25. *Id.* at 150.

26. *Id.* at 143.

27. *Id.*

28. *Id.* at 142-43.

29. When an insurer wrongfully refuses to defend, it may be liable for the cost of the insured’s defense as well as for any judgment rendered against the insured. *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 178-79 (Cal. 1966). In addition, the wrongful failure to defend may be considered a breach of the insurer’s covenant of good faith and fair dealing and subject the insurer to additional liability. *Id.* at 168; *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1155 (Cal. 1993). Punitive damages may be awarded if the failure to defend was fraudulent, oppressive, or malicious. CAL. CIV. CODE § 3294 (Supp. 1994). *See, e.g.*, *Silberg v. California Life Ins. Co.*, 521 P.2d 1103, 1110 (Cal. 1994).

30. *See supra* note 10 and accompanying text. *See, e.g.*, *Select Ins. Co. v. Superior Court*, 276 Cal.Rptr. 598, 599 (Ct. App. 1990) (stating that the insurers filed a complaint for declaratory relief claiming lack of coverage and severe prejudice caused by the insured’s failure to provide timely notice of a third party suit).

31. *See, e.g.*, *Montrose*, 861 P.2d at 1156 (indicating that Montrose filed a declaratory relief action seeking a declaration that its insurers owed a duty to defend).

32. *See, e.g.*, *Gray*, 419 P.2d at 170 (stating that the insured filed a declaratory relief action charging his insurer with a breach of the duty to defend after a judgment was entered against him in the underlying third party suit).

33. Haggerty, *supra* note 2, at 4.

itself in both actions at the same time. One attorney has publicly accused insurance companies of using this as a “very potent tactical weapon” against its policyholders.<sup>34</sup> On the other hand, it is also common for the insurer to provide a defense to the insured while reserving its right<sup>35</sup> to deny coverage in the future, in which case, the insured must only finance its own defense in a coverage action if one is filed.<sup>36</sup>

*Gray v. Zurich Insurance Company*<sup>37</sup> is the leading case in California on an insurer’s duty to defend. *Gray* is also recognized as part of the general trend by courts to expand the duty to defend beyond the terms of the insurance contract.<sup>38</sup> In *Gray*, the insured tendered a defense to his liability insurer soon after a third party filed suit against him alleging a willful, malicious, and intentional assault. Although the insured claimed he acted in self defense, the insurer claimed there was no duty to defend on three grounds: (1) the policy contained an exclusion for intentional acts and the allegations on the face of the complaint alleged bodily injuries caused by the insured’s intentional acts; (2) providing coverage would violate the California statute prohibiting insurance coverage for intentional acts,<sup>39</sup> and (3) there was a conflict of interest between the insurer and the insured.<sup>40</sup> Neither the insured nor the insurer filed a declaratory relief action to resolve coverage issues while the third party suit was pending. However, once the court in the underlying action entered judgment against the insured for assault and

34. *Id.*

35. LATHROP, *supra* note 6, at § 8.03[1][d]. (stating that “[a] reservation of rights is a process whereby a primary insurer reserves its rights to contest the existence of coverage under a particular policy, and at the same time agrees to respond under that policy as though there were valid coverage.”).

36. One commentator has stated:

[A]n insurer may respond to a tender of defense in one of three ways. First, an insurer may deny that it has a duty to defend under the policy. If the policyholder believes that the insurer’s denial was incorrect, the policyholder can bring an action for damages and a declaratory judgment that the insurer is obligated to defend under the policy. Second, an insurer may simply accept its duty to defend unconditionally. If it later attempts to deny coverage or to assert a reservation of its right to deny coverage, a court may find that the insurer has waived or is estopped from denying coverage. Finally, an insurer may decide to accept the defense subject to a reservation of its right to deny coverage later. An insurer who accepts the defense under a reservation of rights must assert its specific policy defenses in its reservation of rights letter to the policyholder, or it will be estopped from later asserting those defenses.

Karen R. Hornbeck & Carl E. Forsberg, *Insurance Coverage for Pollution Liability in Washington: What Constitutes “Damages” Under Comprehensive General Liability Insurance Policies? The Insurer’s Perspective*, 28 GONZ. L. REV. 625, 644 (1992/93) (citations omitted).

37. 419 P.2d 168 (Cal. 1966).

38. Fischer, *supra* note 17, at 150-55, 159-60; Robert J. Federman & Suzanne R. Ruder, *Gray Turns to Black: Further Expansion of Duties to Defend the Insured*, FED’N OF INS. COUNS. Q., Summer 1985, at 351.

39. *Gray*, 419 P.2d at 170, 177; CAL. INS. CODE § 533 (West 1993) (“An insurer is not liable for loss caused by the wilful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured’s agents or others.”).

40. *Gray*, 419 P.2d at 170-71.

awarded considerable damages to the third party, the insured filed suit charging his insurer with a breach of its duty to defend.<sup>41</sup>

Because judgment had been entered against the insured in the underlying action, the circumstances in *Gray* were different from the usual case where a decision to defend is made prospectively at the outset of litigation between the insured and a third party.<sup>42</sup> The fact that a judgment had already been entered against the insured allowed the court to view and rule on the insurer's refusal to defend in retrospect. The insurer's position was that the judgment further supported its argument that its refusal to defend was justified since the court had indeed found an intentional assault, which was not covered under the policy.<sup>43</sup> However, the court looked at the underlying third party action prospectively and held that the insurer should have provided a defense because of the potential for a "judgment based upon nonintentional conduct," which did fall within coverage.<sup>44</sup> *Gray* established that the duty to defend is viewed prospectively, and that an insurer has a duty to defend whenever facts learned from "the complaint, the insured, or other sources" indicate that there is a "potential of liability under the policy."<sup>45</sup>

## II. THE FACTS AND THE HOLDING OF *MONTROSE*

### A. *The Underlying Action*

Montrose Chemical Corporation manufactured the pesticide commonly known as "DDT" from 1947 until 1982.<sup>46</sup> When it was first developed, experts believed that DDT would stop the spread of malaria throughout the world by exterminating the mosquitos that carry the disease.<sup>47</sup> However, in 1962 a marine biologist named Rachel Carson published the results of a scientific study indicating that when released into the environment, pesticides "were taken up in the food chain and could be harmful or fatal to the birds and animals which ate food containing pesticide residues."<sup>48</sup> DDT was the major target of this study. When the study gained national attention, it was vigorously attacked by the Chemical Manufacturers Association,<sup>49</sup> but this opposition was not enough to overcome the well-documented results of the

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41. *Id.* at 170.

42. See Fischer, *supra* note 17 and text accompanying notes 26 and 27.

43. *Gray*, 419 P.2d at 170.

44. *Id.* at 176.

45. *Id.* at 177.

46. *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1155 (Cal. 1993).

47. Petitioner's Answer to the Travelers Indemnity Company's Opening Brief on the Merits at 4 n.5, *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153 (Cal. 1993) (No. S024390).

48. *Montrose*, 861 P.2d at 1155; LATHROP, *supra* note 6, § 1.02[1] (citing RACHEL CARSON, *THE SILENT SPRING* (1987)).

49. LATHROP, *supra* note 6, § 1.02[1].



study or the adverse publicity. In 1972 the federal government prohibited the use of DDT in the United States because of the very reasons advanced in Rachel Carson's study.<sup>50</sup> Despite the ban on its use in the United States, Montrose continued to manufacture DDT for export until 1982. Montrose claims to have disposed of its industrial wastes in compliance with a governmental permit.<sup>51</sup> Montrose has also asserted that it did not expect or intend to cause damage to the environment.<sup>52</sup>

Sometime in 1990, Montrose was sued by the federal government and the State of California<sup>53</sup> under the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA").<sup>54</sup> The CERCLA action alleged that Montrose and others disposed of hazardous substances<sup>55</sup> at the Stringfellow Acid Pits in Riverside County, California.<sup>56</sup> The hazardous waste deposited in the Stringfellow Acid Pits eventually leached into the groundwater, threatening the entire water supply for the surrounding community.<sup>57</sup>

In addition to the claims brought against Montrose by the federal government and the State of California under CERCLA, the Los Angeles

50. *Id.*

51. Petitioner's Answer to the Travelers Indemnity Company's Opening Brief on the Merits at 25 n.45, *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153 (Cal. 1993) (No. S024390). See also Jerry L. Anderson, *The Hazardous Waste Land*, 13 VA. ENV'T L.J. 1, 26-27 (1993) (citations omitted).

While most operators assumed that their disposal techniques were permissible due to the absence of contrary government regulation, in some cases their disposal practices were explicitly approved by government authority. Other landfills were operated by the local government itself, leading disposers to reasonably believe that the operation was proper. Moreover, land disposal of industrial waste actually was preferable to the common technique of discharging directly into watercourses or sewers. Ironically, those industries that used water-based disposal do not have to deal with the dormant liability that land-based disposers now face. . . . [However,] the actual culpability of [disposers of hazardous waste] varies widely. Some were using the state-of-the-art treatment techniques and used due care based on the existing knowledge of potential danger, while others were clearly negligent in failing to implement known treatment techniques.

52. Petitioner's Answer to the Travelers Indemnity Company's Opening Brief on the Merits at 25 n.45, *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153 (Cal. 1993) (No. S024390).

53. *United States v. Stringfellow*, Cent. Dist. of Cal. Case No. 83-2501.

54. 42 USC § 9601 (1994) amended by Superfund Amendments and Reauthorization Act of 1986 ("SARA"), Pub. L. 99-499, 100 Stat. 1613, approved October 17, 1986. See also Lewis M. Barr, *CERCLA Made Simple: Analysis of the Cases Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980*, 45 BUS. LAW. 923, 924 (1990) (quoting *Chem. Waste Management v. Armstrong World Indus.*, 669 F. Supp. 1285, 1290 n.6 (E.D. Pa. 1987)) (indicating that the major policy goals of CERCLA are "to encourage maximum care and responsibility in the handling of hazardous waste; to provide for rapid response to environmental emergencies; to encourage voluntary clean-up of hazardous waste spills; to encourage early reporting of violations of the statute; and to ensure that parties responsible for release of hazardous substances bear the costs of response and costs of damage to natural resources.").

55. See 42 U.S.C. § 9601(14) (Supp. 1994).

56. See *Montrose Chem. Corp. v. American Motorists Ins. Co.*, 16 Cal. Rptr. 2d 516, 520 (Ct. App. 1993).

57. *Id.*

County Sanitation District filed a cross-complaint alleging Montrose was responsible for property damage under strict liability and negligence theories.<sup>58</sup> Montrose has also been named in numerous other civil suits for damages caused by its hazardous waste disposal practices.<sup>59</sup>

### B. An Overview of CERCLA

An analysis of the California Supreme Court's decision in *Montrose* would be incomplete without considering the impact of CERCLA on both commercial policyholders and their insurers. *Montrose* is only one case in the morass of disputes over who should be responsible for clean-up costs under CERCLA.<sup>60</sup> CERCLA grants the executive branch of the federal government the power to respond to environmental contamination problems and to seek reimbursement from responsible parties in a civil suit.<sup>61</sup> The federal government may also compel responsible parties to undertake cleanup actions.<sup>62</sup>

Under CERCLA, a generator of hazardous waste, such as Montrose, faces an enormous potential for liability that is difficult to escape. The cost of defending a CERCLA suit and cleaning up a hazardous waste site is so enormous that it can threaten the financial viability of companies forced to take responsibility for a portion of the expense.<sup>63</sup> This creates a powerful incentive to avoid liability and/or to shift the burden of liability under CERCLA, as well as the costs of defending a CERCLA suit, to insurance companies.<sup>64</sup> In turn, insurance companies realize that their financial viability is also threatened if policyholders are successful in passing on the

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58. *Montrose*, 861 P.2d at 1155.

59. *E.g.*, *Newman v. Stringfellow*, Riverside County Super. Ct. Case No. 165994MF; *Parr-Richmond Terminal Co. v. Levin Metals Corp.*, Northern Dist. of Cal. Case No. 85-4776 SC; *Levin Metals Corp. v. Parr-Richmond Terminal Co.*, Northern Dist. of Cal., Case Nos. 84-6273 SC and 84-6324 SC.

60. See Mitchell L. Lathrop, *Environmental Insurance Coverage Disputes from the Perspective of the Insurer*, in ENVIRONMENTAL AND TOXIC TORT CLAIMS, INSURANCE COVERAGE IN 1990 AND BEYOND, at 131, 149 (PLI Com. Law and Practice Course Handbook Series No. 536, 1990).

61. *Id.* at 150 n.6 (explaining that CERCLA delegates authority to the President, but the President has by executive order transferred most of this authority to the United States Environmental Protection Agency (EPA)).

62. 42 U.S.C. § 9607(a) (1994).

63. Sharon M. Murphy, Note, *The "Sudden and Accidental" Exception to the Pollution Exclusion Clause in Comprehensive General Liability Insurance Policies: The Gordian Knot of Environmental Liability*, 45 VAND. L. REV. 161, 173 (1992). See also Anderson, *supra* note 50, at 10-11 (indicating that the average cost of a remedial investigation/feasibility study is \$1.3 million and that the average cost of clean-up at each site ranges from \$26 million to \$50 million per site.).

64. Murphy, *supra* note 63, at 173 (citing ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE, § 10A.04 (1990)).

costs involved in defending CERCLA actions and paying clean up costs.<sup>65</sup> As a result, too many resources are being spent to avoid liability rather than to clean up hazardous waste, which means that our national goal to clean up the environment is not being realized as efficiently as possible.<sup>66</sup>

CERCLA imposes strict,<sup>67</sup> retroactive, and joint and several liability<sup>68</sup> on owners, operators, generators and transporters of hazardous substances.<sup>69</sup> Since Congress intended that successor corporations rather than taxpayers

65. An author has described the problem as follows:

The effect of current environmental claims against pre-1970 general liability policies and judicial decisions decreeing coverage even in the face of policy exclusions has forced insurers to establish reserves and pay claims against current assets and income because of policies issued decades ago. That, of course, . . . could threaten the financial integrity of the entire insurance industry. To put the problem in perspective, America's commercial insurance industry had a surplus of approximately \$137 billion as of June 30, 1990, and loss reserves of \$242 billion, which, of course, are intended to cover a wide variety of claims. As of October 1, 1990, there were approximately 1170 sites slated for cleanup according to the National Priorities List (NPL). At an estimated cleanup cost of \$30 million per site, the cost of cleaning up only those sites currently on the NPL comes to \$35 billion. Add to that the estimated 25,000 sites yet to be included on the NPL and the figure increases to over \$785 billion. Thus, if America's property/casualty insurers are found to be responsible for paying only 50% of the cost of cleaning up the nation's NPL sites, the property/casualty insurance industry will be entirely wiped out.

LATHROP, *supra* note 6, § 1.04[3] (citations omitted). See also Murphy, *supra* note 63, at 175 (citing Brooke Jackson, *Environmental Cleanups and Insurance: Isn't There a Better Way?*, 21 ENV'T REP. (BNA), at 768 (Aug. 10, 1990) (stating that prior to passage of CERCLA in 1980, the premiums paid by policyholders were not commensurate with the risks created by the statute); and LATHROP, *supra* note 6, at § 1.02[2]:

For many insurers, the businesses they insured were such that environmental claims were not even foreseen. For others, while the possibility of such claims might have been foreseen, the magnitude of the losses could not. Moreover, prior to the 1970s, there was less legislative regulation in the environmental area and thus, fewer causes of loss. . . . Since the policies were written and priced years in the past, the amount of premium charged for them was necessarily low . . . .

66. Anderson, *supra* note 51, at 4.

67. One commentator has noted:

Section 9601(32) provides that the CERCLA standard of liability 'shall be . . . the standard of liability' 'which obtains under the Clean Water Act, interpreted at the time of CERCLA's enactment and thereafter to be strict liability. The legislative history of CERCLA shows that Congress established this standard because of its conclusion that anyone engaged in the manufacture, transportation, usage, or disposal of 'hazardous substances' is engaged in an abnormally dangerous or ultrahazardous activity.

Barr, *supra* note 54, at 976. See also Anderson, *supra* note 51, at 19 ("The imposition of liability without fault in the hazardous waste context is entirely in accord with the policies behind imposing strict liability for other extrahazardous activities.

68. As Mr. Burr further noted:

While CERCLA does not mandate the imposition of joint and several liability, the Act permits, and the courts have imposed, such liability in cases of "indivisible harm." Congress anticipated that the courts would "consider traditional and evolving principles of federal common law" on this issue. A defendant seeking to limit its liability on the ground that the harm can be apportioned has the burden of proof not only that the harm is divisible, but also that there is a reasonable and rational basis for apportionment of the harm.

Barr, *supra* note 54, at 977-78 (citations omitted).

69. 42 U.S.C. § 9607(a) (1994). See also Anderson, *supra* note 51, at 6; Barr, *supra* note 54, at 941-947.

bear the costs under CERCLA,<sup>70</sup> courts have held corporate successors<sup>71</sup> liable for the disposal practices of predecessors under a number of theories of successor liability.<sup>72</sup> In addition, Congress has provided only a few very narrow defenses to liability based on causation: (1) an act of God, (2) an act of war, or (3) the act or omission of a wholly-unrelated third party.<sup>73</sup> In other words, CERCLA envisions a rebuttable presumption that owners, operators, transporters, and generators are “causally connected to the release or threat of release at the site.”<sup>74</sup>

In a CERCLA action against a generator<sup>75</sup> of hazardous waste, such as Montrose, the government establishes liability by proving that the generator arranged for the disposal of a hazardous substance found at the site.<sup>76</sup> However, the government’s *prima facie* case is deceptively simple. In the past, owners and operators of sites usually worked on a cash basis and did not keep records.<sup>77</sup> It is typical to find that written receipts or other documentation were lost or destroyed years ago.<sup>78</sup> Often, drums of hazardous substances found at the site are either unmarked or too rusted to be used as evidence of their point of origin.<sup>79</sup> Likewise, key witnesses are often deceased or difficult to locate.<sup>80</sup> In addition, the search for responsible parties frequently produces little more than a list of businesses that are

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70. Barr, *supra* note 54, at 980 (quoting *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 92 (3d Cir. 1988), *cert. denied*, 109 S. Ct. 837 (1989):

Benefits from the use of the pollutant as well as savings resulting from the failure to use non-hazardous disposal methods inured to the original corporation, its successors, and their respective stockholders and accrued only indirectly, if at all, to the general public. We believe it in line with the thrust of the legislation to permit—if not require—successor liability under traditional concepts.

71. Montrose is no longer a viable corporation. At all relevant times, Stauffer Chemical Company (now known as Rhone-Poulenc Basic Chemicals Company) owned 50% of the stock of Montrose. Stauffer is also a party to the CERCLA action. See *Montrose Chem. Corp. v. American Motorists Ins. Co.*, 16 Cal. Rptr. 2d 516, 519-20 (Ct. App. 1993).

72. Anderson, *supra* note 51, at 36-39.

73. 42 U.S.C. § 9607(b) (1994). Other potential defenses include the innocent landowner defense (42 U.S.C. §§ 9601(35) (Supp. 1994) and 9607(b)(3)(a), and (b) (1994)), and the statute of limitations, which requires that the government commence a suit for recovery of costs in three or six years depending on the type of action taken at the site (42 U.S.C. § 9613(g)(2) (Supp. 1994)). In addition, some courts have recognized the availability of equitable defenses. Barr, *supra* note 54, at 991-92.

74. Barr, *supra* note 54, at 984 (quoting *United States v. Miami Drum Servs.*, 25 Env’t Rep. Cas. (BNA) 1469, 1476 (S.D. Fla. 1986)).

75. 42 U.S.C. § 9607(a)(3) (1994) (indicating that liability can be imposed on “any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances. . .”).

76. Anderson, *supra* note 51, at 12 (citing 42 U.S.C. § 9607(a)(3) (1988)).

77. *Id.* at 13.

78. *Id.*

79. *Id.*

80. *Id.*

insolvent or no longer in business.<sup>81</sup> As a result, joint and several liability<sup>82</sup> attaches to the small group of responsible parties that can be located and that are still solvent.<sup>83</sup>

### C. *The Insurance Coverage Dispute in Montrose*

When Montrose tendered its defense to its insurers, the insurers either refused or offered to defend on conditions unacceptable to Montrose.<sup>84</sup> Montrose then filed a declaratory relief action against its insurers seeking a declaration that it was owed a duty to defend.<sup>85</sup> Seeking to establish its insurers' duty to defend without going to trial, Montrose filed a motion for summary adjudication.<sup>86</sup> In its motion, Montrose claimed that under the potential-for-coverage standard set out in *Gray*,<sup>87</sup> it was entitled to a defense in the underlying CERCLA action as a matter of law. Montrose pointed to the allegations of environmental contamination in the complaint and argued that a potential for coverage and a duty to defend were established since the policies covered property damage.<sup>88</sup>

The insurers opposed the motion for summary adjudication on two separate grounds. First, in an action to resolve insurance coverage disputes, the insured has the burden of making a *prima facie* showing that the allegations in the underlying third-party complaint fall within the scope of basic coverage provided by the policy.<sup>89</sup> The insurers claimed Montrose had failed to make this *prima facie* showing,<sup>90</sup> because the environmental contamination alleged in the underlying CERCLA complaint was not "property damage" caused by an "occurrence" as defined in the policies.<sup>91</sup> Under this interpretation, Montrose could only establish a potential for coverage and a duty to defend by showing not only that the underlying CERCLA complaint contained allegations of property damage, but also that any such property damage was caused by "an accident, including continuous or repeated exposure to conditions," which resulted in "property damage neither expected nor intended from the standpoint of the insured . . . ."<sup>92</sup>

Second, the insurers introduced evidence to show that Montrose caused environmental contamination by years of purposeful business decisions rather

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81. *Id.* at 11-12.

82. Barr, *supra* note 54, at 977-78.

83. Anderson, *supra* note 51, at 12.

84. *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1155 (Cal. 1993).

85. *Id.* at 1156.

86. *Id.* See also *supra* note 11.

87. See *supra* note 45 and accompanying text.

88. *Montrose*, 861 P.2d at 1156.

89. See *infra* note 153 and accompanying text.

90. *Montrose*, 861 P.2d at 1156.

91. *Id.*

92. *Id.*

than from an “accident” or “occurrence” as defined in the policies.<sup>93</sup> According to the insurers, the results of such deliberate business practices fell outside the definition of “accident” or “occurrence” as defined in the policies since they constitute damage that was “expected or intended from the standpoint of the insured.”<sup>94</sup>

The trial court denied Montrose’s motion for summary adjudication for two reasons. First, Montrose had failed to make a *prima facie* showing that there was a potential for coverage of the underlying CERCLA action.<sup>95</sup> According to the trial court, the factual allegations contained in the underlying CERCLA complaint were inconclusive or “neutral” in that they did not indicate whether the environmental contamination resulted from an accident or “occurrence.”<sup>96</sup> Apparently, the trial court came to this conclusion because CERCLA imposes strict liability, and the government in a CERCLA action must only allege that Montrose arranged for the disposal of hazardous substances found at a disposal site.<sup>97</sup> Consequently, the allegations in the underlying CERCLA complaint did not specify whether the environmental contamination resulted from negligent or intentional acts.<sup>98</sup> The trial court concluded that to meet its burden of proof, Montrose would need to provide an affirmative evidentiary showing that the alleged contamination resulted from an accident or “occurrence.”<sup>99</sup> Second, the trial court found that the insurers had introduced evidence which created a triable issue of fact as to whether the alleged contamination fell within the definition of “occurrence.”<sup>100</sup>

Having failed to convince the trial court that there was a potential for coverage, Montrose was faced with waging a “two-front war.”<sup>101</sup> Montrose was forced to pay the costs of its own defense in the underlying CERCLA action and litigate the coverage action on the “occurrence” issue. Finding this unacceptable, Montrose sought and was granted a writ by the California Court of Appeal.<sup>102</sup> In the appellate proceeding, Montrose raised two major issues. First, Montrose claimed the allegations of the CERCLA complaint and the terms of its insurance policies were sufficient

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93. *Id.*

94. *Id.* at 1155-56.

95. *Id.*

96. *Id.*

97. See *supra* text accompanying notes 69 and 76.

98. See *Montrose Chem. Corp. v. Superior Court*, 10 Cal. Rptr. 2d 687, 692 (Ct. App. 1992) (depublished).

99. *Montrose*, 861 P.2d at 1153, 1156.

100. *Id.*

101. See *supra* text accompanying note 33.

102. See *Montrose Chem. Corp. v. Superior Court*, 10 Cal. Rptr. 2d 687, 689 (Ct. App. 1992) (depublished).

to establish a potential for coverage.<sup>103</sup> Second, Montrose alleged that once a potential for coverage is established, the insurers may not introduce extrinsic evidence (i.e., evidence outside of the complaint and the insurance policies) to defeat the duty to defend by showing Montrose acted deliberately or intentionally.<sup>104</sup>

The appellate court found that Montrose had established a potential for coverage as a matter of law and that the insurers therefore had a duty to defend.<sup>105</sup> The appellate court pointed to three different factors for its conclusion. First, the court noted that the underlying CERCLA complaint was seeking "natural resource damages" and "response costs," which are considered property damage under California law.<sup>106</sup> Second, even though the CERCLA complaint did not specifically allege that the environmental contamination was the result of negligent or intentional acts, the court in the underlying action could possibly find Montrose liable for nonintentional conduct falling within the definition of "occurrence."<sup>107</sup> The court's opinion did not explain why it would be necessary to make such a determination in an action for strict liability. However, the court did mention that the cross-complaint filed by the Los Angeles County Sanitation District alleges negligence, so that Montrose could possibly be found liable "for unintentional acts resulting in unexpected injuries."<sup>108</sup>

#### D. The California Supreme Court's Decision

The California Supreme Court agreed with the Court of Appeal that pursuant to *Gray*,<sup>109</sup> the insurers owed Montrose a defense since Montrose was able to demonstrate a potential for coverage based solely on the allegations in the underlying CERCLA complaint.<sup>110</sup> The court held that an insured may establish a duty to defend in a motion for summary adjudication by making a *prima facie* showing that facts learned from the

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103. *Id.* at 690.

104. *Id.* In *Gray v. Zurich Ins. Co.*, 419 P.2d 168 (Cal. 1966), the California Supreme Court made clear that the allegations on the face of the complaint as well as any extrinsic facts known to the insurer could be used to establish a potential for coverage and the duty to defend. *Id.* at 177. However, California courts were divided as to whether an insurer could use extrinsic facts or evidence to show there was no potential for coverage and no duty to defend. *Montrose*, 861 P.2d at 1158-59 (citing *State Farm Mut. Ins. Co. v. Flynt*, 95 Cal. Rptr. 296, 302 (Ct. App. 1971); *Saylin v. Cal. Ins. Guar. Ass'n*, 224 Cal. Rptr. 493, 497 (Ct. App. 1986); *Fire Ins. Exchange v. Jimenez*, 229 Cal. Rptr. 83, 85 (Ct. App. 1986); *CNA Casualty of Cal. v. Seaboard Sur. Co.*, 222 Cal. Rptr. 276, 279-80 (Ct. App. 1986); *Remmer v. Glens Falls Indem. Co.*, 295 P.2d 19, 22-23 (Ct. App. 1956); *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750, 752-53 (2d Cir. 1949).

105. *See Montrose Chem. Corp. v. Superior Court*, 10 Cal. Rptr. 2d 687, 694 (Ct. App. 1992) (depublished).

106. *Id.* at 692 (citing *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1279 (Cal. 1990)).

107. *Montrose*, 861 P.2d at 692.

108. *Id.*

109. *Gray*, 419 P.2d at 177. *See also supra* text accompanying notes 37-45.

110. *Montrose*, 861 P.2d at 1156, 1164.

complaint, the insurance policies, and other sources indicate that there is a potential for coverage.<sup>111</sup> Several factors convinced the court that Montrose had established a potential for coverage.

First, the court noted that environmental contamination is considered “property damage” under California law.<sup>112</sup> Second, claims for environmental contamination may fall within the definition of “property damage” in the policies if the damages were “not expected or intended” by Montrose.<sup>113</sup> The court confirmed that under California law, “expected” damage is subjective and requires proof that the insured actually “knew or believed its conduct was substantially certain or highly likely to result in that kind of damage.”<sup>114</sup>

Finally, the court reasoned that even though the CERCLA complaint did not specifically allege whether the environmental contamination was caused “negligently” or “intentionally” by Montrose, the allegations at least raised the “possibility that Montrose would be liable for property damage covered by the policies.”<sup>115</sup> If Montrose intentionally or deliberately caused environmental contamination, any resulting damage would be considered “expected” or “intended” by Montrose and would therefore not be covered under the policies.<sup>116</sup>

According to the California Supreme Court, as long as the “possibility” exists that Montrose was negligent, the insurers must immediately defend unless and until they can conclusively establish by “undisputed facts” that there is *no* potential for coverage.<sup>117</sup> The court also held that the insurers were entitled to introduce evidence extrinsic to the insurance policies and the underlying CERCLA complaint in order to establish by “undisputed facts” that there is *no* potential for coverage.<sup>118</sup> The court acknowledged that extrinsic evidence introduced by the insurers in their opposition to the motion

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111. *Id.* at 1161.

112. *Montrose*, 861 P.2d at 1163 (citing *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1279 (Cal. 1990)).

113. *Montrose*, 861 P.2d at 1163.

114. *Id.* (citing *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 836 (Ct. App. 1993)).

115. *Id.* at 1164. (For example, if Montrose negligently caused environmental contamination, any resulting damage to a third party’s property could fall within the basic coverage provided to Montrose because negligence would imply that the contamination was “neither expected nor intended” by Montrose).

116. *Id.*

117. *Id.* at 1161. *See also* Anderson, *supra* note 51, at 25:

Most CERCLA defendants would not meet the traditional common law elements of negligence because they had observed the standard of care of the time period for disposing of hazardous substances on land. Although their waste disposal practices may now seem primitive and reckless, the [disposers of hazardous waste] were simply following the state of the art techniques then in use.

118. *Id.* at 1159-60.



for summary adjudication established the existence of a triable issue of fact.<sup>119</sup> However, the court found that this evidence was inconclusive and was therefore not enough to defeat a finding that there was a “potential” or “possibility” of coverage.<sup>120</sup>

In addition to addressing the major issues raised by the parties, the court in *Montrose* expressed concern in dicta about the possible prejudicial effects of deciding insurance coverage issues that could also be tried in the underlying CERCLA action.<sup>121</sup> The court implied that the issues of intent or negligence on the part of Montrose could be tried in both suits.<sup>122</sup> If such issues were resolved first in the insurance coverage action, Montrose could be collaterally estopped from relitigating these issues against the plaintiffs and cross-complainants in the underlying CERCLA action.<sup>123</sup> To resolve the potential for prejudice, the court endorsed the use of discretion by the trial court to order a stay<sup>124</sup> of issues in the coverage action that will also be decided in the underlying third party suit.<sup>125</sup> The court said that granting a stay protects the insured from the prejudice that might result from having to try the same issue in two separate suits.<sup>126</sup> The court did say that insurers may be able to proceed to trial on issues in the coverage action that are logically unrelated to the issues in the underlying third party action.<sup>127</sup>

### III. THE PRACTICAL EFFECTS OF *MONTROSE*

Three aspects of the *Montrose* decision demonstrate that it is part of the continuing trend by courts to expand defense obligations through judicial interpretation that favors policyholders and disfavors providers of insurance. First, the *Montrose* court reached its decision based on judicial construction of the duty to defend without analyzing the particular policy language at issue, or the intent of the parties to the insurance contract. Second, *Montrose* conflicts with long-standing precedent on the insured’s burden of proof in actions to resolve coverage disputes. Finally, when an insurance

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119. *Id.* at 1164.

120. *Id.* at 1163-64.

121. *Id.* at 1162.

122. *Id.*

123. *Id.*

124. A “stay” is “a suspension of the case or some designated proceedings within it. It is a kind of injunction with which a court freezes its proceedings at a particular point. It can be used to stop the prosecution of the action altogether, or to hold up only some phase of it, such as an execution about to be levied on a judgment.” BLACK’S LAW DICTIONARY 1413 (6th ed. 1990).

125. *Montrose*, 861 P.2d at 1162.

126. *Id.*

127. *Id.* See also *Montrose Chem. Corp. v. Superior Court*, 31 Cal. Rptr. 2d 38, 43-44 (1994) (ordering the trial court to determine which issues could be tried without prejudicing the insured in the underlying action and to schedule a trial date; the appellate court more fully addressed the issue of prejudice but advised the trial court to balance the conflicting interests of Montrose and its insurers).

coverage action involves issues that will also be decided in the underlying third party suit, the normal rules applicable to summary disposition do not apply, and the insurer's rights under the insurance contract may be curtailed in favor of the insured.

#### A. Insurance Policy Interpretation

In determining whether there was a duty to defend, the court in *Gray* applied the "reasonable expectations" doctrine.<sup>128</sup> Reasonable expectations is an equitable doctrine that permits courts to intervene on behalf of the insured "to prevent the insurer from inflicting an unfair bargain on the insured."<sup>129</sup> The doctrine is based on the assumption that standardized insurance policies are contracts of adhesion offered to the general public on a mass basis.<sup>130</sup> Courts are more likely to apply the reasonable expectations doctrine where the insured is an ordinary consumer without sophisticated knowledge or understanding of insurance.<sup>131</sup> The reasonable expectations doctrine was derived from the well-settled principle that ambiguities in a contract must be resolved against the drafter of the contract.<sup>132</sup> According to the court in *Gray*, if the policy language is ambiguous, its meaning must be tested "according to the insured's reasonable expectation," and if the insured could reasonably expect coverage, the insurer cannot be relieved of its duty to defend.<sup>133</sup>

In *Gray*, the California Supreme Court found two independent sources of ambiguity in the insurance policy. First, the court found ambiguity in the policy language. The coverage provisions of the policy contained the standard promises "to 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" and to "defend any suit against the insured alleging such bodily injury or property damage and seeking damages which are payable under the terms of this endorsement, even if any of the allegations of the suit are groundless, false or fraudulent."<sup>134</sup> The court said that if these terms were read in a vacuum, the insured could reasonably expect a defense of any suit seeking damages for bodily injury, whether or not the allegations suggested intentional or inadvertent injury.<sup>135</sup>

128. *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 171-72 (Cal. 1966).

129. James M. Fischer, *Why Are Insurance Companies Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995, 1008-15 (1992).

130. *Id.*

131. Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151, 1154 (1981).

132. *Gray*, 419 P.2d at 171-72.

133. *Id.* at 169-70.

134. *Id.* at 173.

135. *Id.* at 173-74.

The insurer argued that it should be relieved of its duty to defend based on the phrase "seeking damages which are payable under the terms of this endorsement," together with language listed under a separate section entitled "Exclusions."<sup>136</sup> Under "Exclusions," the policy stated that coverage did not apply "to bodily injury caused intentionally by . . . the insured."<sup>137</sup> However, the court found the relationship of this exclusionary language to the basic promises in the policy unclear. The court noted that the exclusionary clause was part of a long and complicated page of fine print and therefore did not meet the requirement that exclusionary clauses be "conspicuous, plain and clear."<sup>138</sup> Since the language of the policy could have been clarified by the drafter,<sup>139</sup> the court found that the duty to defend as written in the policy was a primary one, and that the insured could reasonably expect protection under the circumstances.<sup>140</sup>

Second, the court in *Gray* found that "the nature of the obligation to defend" was "necessarily uncertain."<sup>141</sup> According to the court, this uncertainty arises because, "[n]o one can determine whether the third party suit does or does not fall within the indemnification of the policy until that suit is resolved."<sup>142</sup> The insurer's obligation to indemnify the insured "will not be defined until the adjudication of the very action which it should have defended."<sup>143</sup> Once again, the result is that an insurer may be required to "defend against claims it has not contractually agreed to cover because of the potential that claims the insurer *has* agreed to cover may be asserted against the insured."<sup>144</sup>

In contrast to *Gray*, the court in *Montrose* did not base its decision on any ambiguity in the policy language, nor did the court make any suggestion that the insurance contract in *Montrose* was entitled to special interpretation based on the insured's reasonable expectations. Nevertheless, the court relied heavily on *Gray* and implied that the reasonable expectations doctrine was a factor in its decision making process when it mentioned that California courts have been "consistently solicitous of the insureds' expectations" with respect to the duty to defend.<sup>145</sup> Accordingly, *Montrose* was given the benefit of the reasonable expectations doctrine with no attempt by the court to analyze whether the terms of the policy were ambiguous, or whether a sophisticated corporate purchaser of insurance is entitled to the same equitable treatment as an ordinary consumer with no specialized knowledge

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136. *Id.* at 174.

137. *Id.*

138. *Id.* (citing *Steven v. Fidelity & Cas. Co.*, 377 P.2d 284, 294 (Cal. 1962)).

139. *Gray*, 419 P.2d at 174.

140. *Id.* at 171.

141. *Id.* at 173.

142. *Id.*

143. *Id.*

144. See *supra* notes 25-26 and accompanying text.

145. *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153, 1157 (Cal. 1993).

or understanding of insurance. Although the *Montrose* decision is silent in this regard, it is reasonable to assume that Montrose was a sophisticated purchaser of insurance. In fact, it is common among large companies to retain “in-house risk managers” who are specially trained experts in the field of insurance.<sup>146</sup> Thus, it is likely that Montrose purchased its insurance with an understanding of the limits of the duty to defend as expressed in the policy language and by earlier California court decisions which have recognized that the duty to defend is not absolute.<sup>147</sup>

More importantly, the policy language at issue in *Montrose* was different from that interpreted by the court in *Gray*. However, the court in *Montrose* did not consider the obvious differences in policy language defining the duty to defend even though the court in *Gray* suggested that a clarification of policy language might have changed the result.<sup>148</sup> The policy in *Montrose* contained similar basic promises to indemnify Montrose for “bodily injury or property damage . . . caused by an occurrence” and to provide a defense of “any suit . . . seeking damages on account of bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent.”<sup>149</sup> Unlike the court in *Gray*, it was not necessary for the court in *Montrose* to focus its analysis on a separate, unclear, and inconspicuous intentional acts exclusion in small print. Rather, the basic coverage provisions of the policies issued to Montrose extended defense and indemnity *only* to “property damage . . . caused by an occurrence,” which was defined as “an accident, including continuous or repeated exposure to conditions which results in . . . property damage neither expected nor intended from the standpoint of the insured . . . .”<sup>150</sup>

### B. *The Insured's Burden of Proof*

The California Supreme Court allowed Montrose to establish a potential for coverage on a minimal burden of proof. As articulated by the court in *Gray* and ostensibly followed by the court in *Montrose*, the duty to defend extends only to “the nature and kind of risks covered by the policy.”<sup>151</sup> California courts have followed the rule that “the burden is on the insured

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146. LATHROP, *supra* note 6, § 1.04[3].

147. *See, e.g.*, St. Paul Fire and Marine Ins. Co. v. Superior Court, 208 Cal. Rptr. 5, 7 (Ct. App. 1984); Giddings v. Indus. Indem. Co., 169 Cal. Rptr. 278, 280 (Ct. App. 1980).

148. *Gray*, 419 P.2d at 171, 173.

149. *Montrose*, 861 P.2d at 1155.

150. *Id.*

151. *Gray*, 419 P.2d at 175; *see also Montrose*, 861 P.2d at 1160, 1161.

to prove an event is a claim within the scope of basic coverage.”<sup>152</sup> Thus, to establish a breach of the duty to defend under the policy language at issue in this case, Montrose should have been required to “prove the existence of a *potential for coverage*”<sup>153</sup> by showing that the claims in the underlying action constituted covered property damage and that any such property damage was caused by an “occurrence.” Other California courts interpreting similar policy language, including the trial court in this case, have recognized the necessity for including an analysis of the “occurrence” issue in determining whether a duty to defend exists.<sup>154</sup> For example, the court in *Hurley Construction Company v. State Farm Fire and Casualty Company*,<sup>155</sup> acknowledged that an accidental “occurrence” was the triggering event and that “[n]o duty to defend arose unless the third party claim involved an

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152. *Garvey v. State Fire and Farm Cas. Co.*, 770 P.2d 704, 710 (Cal. 1989) (“First and third party coverage is today typically provided in a single policy, and under both types of coverage, once the insured shows that an event falls within the scope of basic coverage under the policy, the burden is on the insurer to prove a claim is specifically excluded.”). See also *Keating v. Nat’l Union Fire Ins. Co.*, 995 F.2d 154, 156 (9th Cir. 1993); *Olympic Club v. Those Interested Underwriters at Lloyd’s London*, 991 F.2d 497, 502-03 (9th Cir. 1993); *Allstate Ins. Co. v. Salahudin*, 815 F. Supp. 1309, 1310-11 (N.D. Cal. 1992); *Bailey v. State Farm Ins. Co.*, 810 F. Supp. 267, 269 (N.D. Cal. 1992); *Allstate Ins. Co. v. Morgan*, 806 F. Supp. 1460, 1463 (N.D. Cal. 1992); *Allstate Ins. Co. v. LaPore*, 762 F. Supp. 268, 270 (N.D. Cal. 1991); *Hartford Fire Ins. Co. v. Karavan Enter., Inc.*, 659 F. Supp. 1075, 1076 (N.D. Cal. 1986); *Clemmer v. Hartford Ins. Co.* 587 P.2d 1098, 1105 (Cal. 1978); *Zuckerman v. Underwriters at Lloyd’s London*, 267 P.2d 777, 784 (Cal. 1954); *Collin v. American Empire Ins. Co.*, 26 Cal. Rptr. 2d 391 (1994); *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 843 (Ct. App. 1993); *Central Nat’l Ins. Co. v. Superior Court*, 3 Cal. Rptr. 2d 622, 625 (Ct. App. 1992); *American Star Ins. Co. v. Ins. Co. of the West*, 284 Cal. Rptr. 45, 48 (Ct. App. 1991); *Masonite Corp. v. Great Am. Surplus Lines Ins. Co.*, 274 Cal. Rptr. 206, 212 n.7 (Ct. App. 1990); *Nat’l Auto. & Cas. Ins. Co. v. Stewart*, 272 Cal. Rptr. 625, 631 (Ct. App. 1990); *Masonite Corp. v. Great Am. Surplus Lines Ins. Co.*, 274 Cal. Rptr. 206, 212 n.7 (1991); *Allstate Ins. Co. v. Interbank Fin. Servs.*, 264 Cal. Rptr. 25, 27 (Ct. App. 1989); *Dyer v. Northbrook Property & Casualty Ins. Co.*, 259 Cal. Rptr. 298, 302 (Ct. App. 1989); *Hallmark Ins. Co. v. Superior Court*, 247 Cal. Rptr. 638, 639 (Ct. App. 1988); *Royal Globe Ins. Co. v. Whitaker*, 226 Cal. Rptr. 435, 437-38 (1986); *State Farm Mut. Auto. Ins. Co. v. Spann*, 106 Cal. Rptr. 923, 925 (Ct. App. 1973); *Strubble v. United Servs. Auto. Ass’n*, 110 Cal. Rptr. 828, 831 (Ct. App. 1973); *American Home Assurance Co. v. Essy*, 3 Cal. Rptr. 586, 588-89 (Ct. App. 1960). See also 23 A.L.R. 2d 1243, 1254 (1952) (outlining the general principles on the burden of proof, which include the maxim that, “He who affirms must prove.”).

153. *Montrose*, 861 P.2d at 1161. See also *Gray*, 419 P.2d at 177.

154. *Montrose*, 861 P.2d at 1156. The trial court concluded that Montrose could not establish a potential for coverage “[a]bsent an affirmative evidentiary showing that the contamination alleged in the CERCLA complaint resulted from an accident or occurrence.” See also *St. Paul Fire and Marine Ins. Co. v. Superior Court*, 208 Cal. Rptr. 5, 7 (Ct. App. 1984). (The insurer took the position that it had no duty to defend a suit for wrongful termination of an employee. The policy covered claims for “bodily injury or damage to tangible property resulting from an accidental event” and defined “accidental event” as something the insured did not “expect or intend to happen.” *Id.* The appellate court held that there was no potential for coverage and no duty to defend because the termination of employment was not an “unintentional, unexpected, chance occurrence.” *Id.* *Dyer v. Northbrook Property & Cas. Ins. Co.*, 259 Cal. Rptr. 298, 302-04 (Ct. App. 1989); *Commercial Union Ins. Co. v. Superior Court of Humboldt County*, 242 Cal. Rptr. 454, 455-56 (Ct. App. 1987); *Royal Globe Ins. Co. v. Whitaker*, 226 Cal. Rptr. 435, 437-38 (Ct. App. 1986).

155. 12 Cal. Rptr. 2d 629 (Ct. App. 1992).

'occurrence' neither expected nor intended from the standpoint of the insured."<sup>156</sup>

It is clear that Montrose was able to show that the claims in the underlying action constituted covered "property damage" since, as acknowledged by the California Supreme Court, environmental contamination is considered "property damage" under California law.<sup>157</sup> However, the court did not require that Montrose prove that any alleged "property damage" was caused by an "accident" or "occurrence" in order to establish a duty to defend. The court declined to do so even though it confirmed that the test for "expected" damage is subjective, meaning that the insured actually "knew or believed its conduct was substantially certain or highly likely to result in that kind of damage."<sup>158</sup> Likewise, California courts have held that "[a]n intentional act is not an 'accident' within the plain meaning of the word."<sup>159</sup> Because Montrose was not required to come forward with affirmative proof that the claims in the underlying action fell within the settled meaning of "occurrence," the California Supreme Court has effectively shifted the burden to the insurers to prove that any alleged property damage falls outside the scope of basic coverage. This directly conflicts with a long line of authority in California on the insured's burden of proof.<sup>160</sup>

In addition, the decision puts an unfair burden on the insurer since the evidence required to show intent or to meet the subjective test for expected damage may be exclusively under the insured's control.<sup>161</sup> For example, under the potential or possibility of coverage standard, Montrose was not required to produce evidence demonstrating to the court or its insurers what its employees knew or believed about the company's hazardous waste disposal practices during the relevant time period.<sup>162</sup> If this information were revealed, it could conclusively establish or negate a potential for coverage by "undisputed facts." This means that Montrose and other

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156. *Id.* at 632.

157. *Montrose*, 861 P.2d at 1163 (citing *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1279 (Cal. 1990)).

158. *Montrose*, 861 P.2d at 1163.

159. *Hurley*, 12 Cal. Rptr. 2d at 632 (citing *Royal Globe Ins. Co. v. Whitaker*, 226 Cal. Rptr. 435, 437 (Ct. App. 1986)).

160. *See supra* note 152.

161. *See, e.g.*, 23 A.L.R. 2d 1243, 1271 (1952) (stating that out of considerations of "fairness, expediency, and convenience," the burden of proof is usually placed "upon a party to prove the existence of facts peculiarly within his own knowledge.").

162. *Montrose*, 861 P.2d at 1163. *But see* Petitioner's Answer to the Travelers Indemnity Company's Opening Brief on the Merits at 25 n.45, *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153 (Cal. 1993) (No. S024390) (indicating that "in an abundance of caution, Montrose introduced extrinsic evidence [in the form of declarations] . . . that Montrose never expected or intended that these wastes would result in any harm to the environment, and that Montrose had no prior knowledge of any alleged pollution caused by its waste disposal practices.").

insureds in similar circumstances will have a strong incentive to prevent their insurers from discovering such information if it would negate coverage.<sup>163</sup>

### C. *The Effect of Common Factual Issues*

Cases with common factual issues frequently arise “where the underlying litigation arguably involves an intentional tort or other intentional conduct, such as an assault or battery.”<sup>164</sup> In such cases, the third party plaintiff in the underlying action must prove the insured acted intentionally in order to prevail. At the same time, the insurer will be inclined to deny coverage and the duty to defend whenever the facts suggest the insured acted intentionally, because insurance policies do not provide coverage for intentional acts.<sup>165</sup> As a result, the insured’s intent may be at issue in both the underlying third party suit against the insured and the action for declaratory relief filed to resolve insurance coverage.

Normally, all parties to a contract have a statutory privilege “in cases of actual controversy” to litigate their “legal rights and duties” under the contract.<sup>166</sup> Although the parties start out with an equal privilege under the statute, *Montrose* effectively elevates the rights of one party to the contract above those of the other. According to the court in *Montrose*, the insurer’s right to resolve a legitimate coverage dispute may be suspended by the trial court when the coverage action involves factual issues that will also be litigated in the underlying third party suit.<sup>167</sup> As a result, the insurer may be forced to forfeit a key provision in the insurance contract granting coverage only for an occurrence.

When the coverage question turns on whether the insured acted intentionally or negligently to cause injury or damage to a third party, the burden of proof imposed on insurers may be insurmountable. Until the California Supreme Court’s decision in *Montrose*, insurers believed that an insured’s motion for summary adjudication on the duty to defend could be overcome just as any other motion for summary adjudication.<sup>168</sup> That is,

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163. Obviously, when there is information tending to show there was an unintended, unexpected accident, the insured would have no reason to conceal this information from its insurer. See *supra* note 39.

164. John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Policies: A Proposed Solution*, 3 UTAH L. REV. 457, 484-85 (1981).

165. See *supra* note 39. But cf. *Horace Mann Ins. Co. v. Barbara B.*, 846 P.2d 792, 797 (Cal. 1993); *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 177 (Cal. 1966) (holding that it is not against public policy to provide a defense to an insured who has been accused of a willful tort).

166. See *supra* note 10 and accompanying text.

167. *Montrose*, 861 P.2d at 1162.

168. See JUDGE ROBERT I. WEIL & JUDGE IRA A. BROWN, JR., CIVIL PROCEDURE BEFORE TRIAL § 10:31 (1993) (stating that to avoid summary judgment, the opposing party must only produce admissible evidence showing a triable issue of fact on a single issue). See also *Montrose*, 861 P.2d at 1161 n.4 (“Effective January 1, 1993, the California statute governing summary judgment practice, Code of Civil Procedure section 437c, was amended. (Stats. 1992, ch. 1348, § 1.). The amendment eliminated the former requirement that a plaintiff moving for

it was assumed that an insurer could defeat an insured's motion for summary adjudication on the duty to defend by establishing that a triable issue of fact existed as to whether the claims in the underlying action fell within the scope of basic coverage.<sup>169</sup> However, in *Montrose*, the court stated that in order to prevail on a motion for summary adjudication on the issue of defense, an insured must merely show that the underlying third party's claims could possibly fall within the basic coverage provided by the policy.<sup>170</sup> Once the insured meets this minimal burden of proof, the insurer must immediately provide the insured with a defense.<sup>171</sup> Unlike the typical opponent to a motion for summary judgment or adjudication, an insurer cannot prevent the granting of the insured's motion by proving the existence of a triable issue of fact as to whether the moving party has met its burden of proof.<sup>172</sup>

According to the court in *Montrose*, the insurer can only prevent the granting of the motion if it can conclusively establish by "undisputed facts" that there is no potential for coverage of the underlying claims.<sup>173</sup> The burden of producing "undisputed facts" is difficult to overcome because intent must often be resolved by the trier of fact.<sup>174</sup> At the summary adjudication phase, the insured can easily claim it acted unintentionally and that it did not expect its practices to cause damage. Such factual disputes must then proceed to trial, thereby extending the time in which the insurer must defend the underlying action. Further, *Montrose* requires that the insurer continue to pay the costs of the insured's defense for the duration of the underlying third party suit by permitting the trial court to order a stay in the coverage action until the third party suit is resolved.<sup>175</sup>

Once a stay is ordered, the insurer's only viable alternative may be to settle what could be an meritless claim in order to avoid spiraling defense

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summary judgment refute each of the defendant's affirmative defenses, thereby bringing California practice in line with federal law. (See Code Civ. Proc. § 437c, subd. (n)(1)).

169. It should be noted that this discussion is limited to disputed issues of fact common to the coverage and underlying third party actions. Where there are no disputed facts, an insurer can still prevail at the summary adjudication or judgment phase by showing that the underlying claims: (1) fall outside basic coverage provisions; (2) fall squarely within an unambiguous exclusion in the policy; or (3) the insured failed to fulfill a condition of coverage. See *Montrose*, 861 P.2d at 1162, 1164-65 (Kennard, J., concurring).

170. *Montrose*, 861 P.2d at 1164.

171. *Id.* at 1163.

172. *Id.* at 1164.

173. *Id.* at 1161.

174. *Id.* at 1161, 1164. See also WEIL & BROWN, *supra* note 168, at § 10:31:

A summary judgment is more likely to be granted in cases based on documentary evidence (e.g., promissory note actions, declaratory relief as to rights under a deed or contract). It is less likely to be granted in cases involving issues of intent, negligence, causation, 'reasonableness' of conduct, etc., because it is simply too easy for your opponent to raise a triable issue of fact in such cases.

175. *Montrose*, 861 P.2d at 1162.



costs, especially in the area of environmental cleanup litigation.<sup>176</sup> When the insurer's right to litigate coverage is suspended by a stay and the insurer settles the underlying action regardless of its duty to indemnify, the effect is a forfeiture of policy language extending coverage only to bodily injury or property damage caused by an occurrence. In other words, "the duty to defend, in effect, becomes the duty to indemnify."<sup>177</sup>

Since the court's declaration of a duty to defend may be used to obtain an order for specific performance,<sup>178</sup> and the insurers may be required to defend until the resolution of the underlying action without a trial of disputed factual issues, the effect of an insured's successful motion for summary adjudication is akin to the granting of a preliminary injunction to the insured without the necessity of fulfilling the requisite burden of proof. Preliminary injunctions<sup>179</sup> are traditionally unavailable unless the plaintiff proves that a suit for damages would be inadequate,<sup>180</sup> "irreparable harm" is imminent,<sup>181</sup> and it is reasonably probable that the plaintiff will prevail on the merits.<sup>182</sup> Essentially, Montrose was granted a preliminary injunction on

176. Katherine Taylor Eubank, *Paying the Costs of Hazardous Waste Pollution: Why is the Insurance Industry Raising Such a Stink?*, 1 U. ILL. L. REV. 173 n.4. See also Alan Pell Crawford, *The Duty to Defend: Insurers Beef Up Their In-House Defense Counsel Staff in Response to Spiraling Legal Costs*, 52 INS. INFO. INST. 40 (1991) ("If insurers are too quick to settle, there is good reason for that. 'Legal costs are so high these days that you can win a case and still end up spending a fortune. From 1978 to 1988, legal costs to insurers rose from \$2.8 billion to \$11.8 billion, growing about 16 percent per year.'").

177. See, e.g., Horace Mann Ins. Co. v. Barbara B., 846 P.2d 792, 804 (Cal. 1993) (Arabian, J., dissenting) (acknowledging that "[i]t is beyond serious dispute that once a duty to defend attaches, the insurer often finds it necessary to fund all or part of a settlement regardless of its underlying duty to indemnify, because the costs of defense may far exceed the settlement offer. The duty to defend becomes, in effect, the duty to indemnify."). But cf. Montrose Chem. Corp. v. Superior Court, 31 Cal. Rptr. 2d 38, 43-44 (Ct. App. 1994) (ordering the trial court to schedule a date for trial of issues unrelated to those in the underlying action).

178. See Montrose Chemical Corp. v. American Motorists Ins. Co., 16 Cal. Rptr. 2d 516, 524-31 (Ct. App. 1993).

179. See generally WEIL & BROWN, *supra* note 168, at §§ 9:500 *et seq.* and CAL. CIV. PROC. CODE §§ 525-535 (West 1994) (under California law, preliminary injunctions are governed by statute and case law).

180. WEIL & BROWN, *supra* note 168, at § 9:519 (injunctions are rarely granted (absent specific statutory authority) where a suit for damages provides a clear remedy). See, e.g., Thayer Plymouth Center, Inc. v. Chrysler Motors Corp., 63 Cal. Rptr. 148 (Ct. App. 1967); Bush v. California Conservation Corps, 185 Cal. Rptr. 892 (Ct. App. 1982); CAL. CIV. PROC. CODE § 526(4) (West 1994) (an injunction may be granted "[w]hen pecuniary compensation would not afford adequate relief.").

181. WEIL & BROWN, *supra* note 168, at § 9:522 (injunctive relief is unlikely unless someone will be harmed in a way which cannot be later repaired. Irreparable harm must be imminent rather than a mere possibility sometime in the future. CAL. CIV. PROC. CODE § 526(2) (West 1994). An injunction may be granted "[w]hen it appears by the complaint or affidavits that the commission or continuance of some act during the litigation would produce waste, or great or irreparable injury, to a party to the action.").

182. To obtain injunctive relief, a party must meet a higher burden of proof than the mere potential for coverage standard embraced by *Montrose*. See, e.g., WEIL & BROWN, *supra* note 168, at § 9:527 (citing San Francisco Newspaper Printing Co., Inc. v. Superior Court, 216 Cal. Rptr. 462 (Ct. App. 1985)) (stating that injunctive relief will not be granted unless it is "reasonably probable that the moving party will prevail on the merits."). See also CAL. CIV. PROC. CODE § 526(1) (West 1994) (an injunction may be granted "[w]hen it appears by the

the duty to defend by showing only a mere possibility of coverage in a motion for summary adjudication and without proving that any of the traditional reasons for the granting of such an injunction were present.

For example, if the trial court in the insurance coverage action held that Montrose deliberately caused environmental contamination, it is possible that Montrose would be collaterally estopped from relitigating this issue against the third party claimant.<sup>183</sup> As one court commented, it would violate public policy and/or the reasonable expectation of the insured if, after paying regular premiums for protection against liability to third parties, the “very resources for which he bargained for would be turned against him and used to establish his liability wherever intentional tort was alleged.”<sup>184</sup>

On the other hand, it has also been recognized that the insurer suffers prejudice if it must often pay defense or indemnity for claims outside the scope of coverage. In particular, defending environmental claims can be extraordinarily expensive because they are so complex.<sup>185</sup> Further, the prospect of providing an insured with a very expensive defense puts pressure on insurers to settle early regardless of merit.<sup>186</sup> This burden has been labeled “inconsequential” compared with the burdens placed on the insured.<sup>187</sup> Admittedly, the burden on the insurance company may appear “inconsequential” when the costs of providing a single policyholder’s defense and/or indemnity are compared with the burden placed on a single ordinary, individual consumer, like the insured in *Gray*.<sup>188</sup> However, when courts continually expand coverage with broad, sweeping policy interpretations, the effect on insurance reserves can be significant and even devastating.<sup>189</sup> In addition, there is no reason to assume that a duty to defend may reasonably be expected by all insureds who are sued or that a similar unfair burden is

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complaint that the plaintiff is entitled to the relief demanded, and the relief, or any part thereof, consists in restraining the commission or continuance of the act complained of, either for a limited period or perpetually.”).

183. *Alhino v. Starr*, 169 Cal. Rptr. 136, 143 (Ct. App. 1980). Where the third party claimant was not a party to the coverage action, it would have to meet three requirements in order to claim the benefit of collateral estoppel. First, the issue decided in the prior adjudication must have been identical with the present action. Second, a final judgment on the merits must have been entered in the prior action. Lastly, the party against whom the doctrine is asserted must have been either a party or in privity with a party in the prior action. *Id.*

184. *Allstate Ins. Co. v. Harris*, 445 F. Supp. 847, 851 (N.D. Cal. 1978). See also William P. Wasserman, Note, *The Role of Declaratory Relief and Collateral Estoppel in Determining the Insurer’s Duty to Defend and Indemnity*, 21 *Hastings L.J.* 191, 214-15 (1969).

185. Eubank, *supra* note 176, at 201-02.

186. See Crawford, *supra* note 176 and accompanying text.

187. *Allstate*, 445 F. Supp. at 852.

188. *Gray*, 419 P.2d at 170 n.1. The named insured in the policy at issue was Dr. Vernon Gray. Dr. Gray was driving an automobile when he nearly collided with another vehicle. When the other driver left his vehicle and approached Dr. Gray’s car, Dr. Gray claimed he feared physical harm. *Id.* As a result, he rose from the seat of his car and struck the other driver. Later, the other driver filed suit against Dr. Gray alleging assault. *Id.*

189. See *supra* note 65.

placed on, for example, a large, sophisticated corporate purchaser of insurance who is denied a defense.

### CONCLUSION

Essentially, *Montrose* allows an insured to establish a duty to defend in a motion for summary adjudication by making a *prima facie* showing that facts learned from the complaint, the policies, and other sources indicate there is a potential for coverage.<sup>190</sup> In opposition, an insurer can introduce evidence extrinsic to the complaint and the policies to show there is no potential for coverage.<sup>191</sup> However, an insurer cannot prevent the granting of an insured's motion for summary adjudication by introducing evidence that creates a triable issue of fact as to whether the claims in the underlying action fall within the scope of coverage.<sup>192</sup> Once a potential for coverage has been established, the insurer must immediately provide the insured with a defense.<sup>193</sup> In order to be relieved of its duty to defend, the insurer must show by "undisputed facts" that there is no potential for coverage of the claims in the underlying action.<sup>194</sup> Where the coverage and underlying third party actions share common factual issues, the insured may be entitled to a stay of these issues in the coverage action until the underlying third party action is resolved.<sup>195</sup> The purpose of a stay is to avoid prejudice that could result from having to try the same issues in both cases.<sup>196</sup> The parties to the coverage action may proceed to trial on issues that are logically unrelated to the undecided issues in the underlying third party action.<sup>197</sup>

In addition to declaring the *Montrose* decision a "sweeping victory" for all insureds, an attorney for *Montrose* said that the court's opinion "puts the nail in the coffin on various arguments the insurance industry routinely makes to avoid defending environmental claims."<sup>198</sup> Undoubtedly, some insurers avoid paying claims that policies were intended to cover, but the motivation to avoid the payment of valid claims is offset by the threat of a cause of action for "bad faith."<sup>199</sup> It is also true that insurance companies have an incentive to pay out the smallest amount possible to cover losses because this allows them to remain competitive in the industry and to earn

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190. *Montrose*, 861 P.2d at 1161.

191. *Id.* at 1159-60.

192. *Id.* at 1164.

193. *Id.* at 1163.

194. *Id.* at 1161.

195. *Id.* at 1162, 1165-65 (Kennard, J., concurring).

196. *Id.*

197. *Id.*

198. Haggerty, *supra* note 2, at 4.

199. LATHROP, *supra* note 6, at § 8.03[2] (citing *Crisci v. Security Ins. Co.*, 426 P.2d 173, 176-79 (Cal. 1967)).

a satisfactory return on their capital.<sup>200</sup> However, insurance companies also have an incentive to overpay valid as well as meritless claims early to avoid the high costs of litigation.<sup>201</sup>

In the long term, sweeping coverage decisions such as *Montrose* are not really a victory for “all insureds,” because policyholders as a group have a strong interest in keeping rates down and ensuring the availability of insurance. Since rates increase whenever the insurer’s costs increase, policyholders depend on their insurers to process claims in a prudent manner, even though this may sometimes conflict with the insured’s competing interest in obtaining indemnity for any and all losses.<sup>202</sup> *Montrose* makes the duty to defend nearly absolute where disputed insurance coverage issues are similar to or the same as issues in the underlying third party action. This interferes with the insurer’s duty to process claims in a prudent manner on behalf of all other policyholders and its stockholders. Even where the facts learned from all sources overwhelmingly point to intentional conduct, the insurer is not free to unilaterally deny a duty to defend without facing a court ruling that it must defend based on a mere possibility of coverage. Indeed, the court in *Montrose* remarked that an insurer would be “well advised to seek a judicial determination that it owes no defense.”<sup>203</sup> In the same breath, however, the court took away the insurer’s ability to seek such a determination since the trial court may order a stay where the insured’s intent is also at issue in the underlying action.<sup>204</sup>

Moreover, *Montrose* conflicts with other California decisions which have recognized that: (1) an insurer may give its own interests consideration equal to that of its insured;<sup>205</sup> (2) an insurer is not required to ignore the interests of its shareholders and other policyholders when evaluating claims;<sup>206</sup> and (3) an insurer is not required to pay uncovered claims even though payment would be in the best interests of the insured.<sup>207</sup>

As the court in *Montrose* validly points out, there are two significant motives for purchasing liability insurance. The first is to obtain indemnity for potential liability, and the other is “to secure the right to call on the insurer’s superior resources for the defense of third party claims.”<sup>208</sup>

200. Morris, *supra* note 164, at 459.

201. See Crawford, *supra* text accompanying note 176.

202. Morris, *supra* note 164, at 460.

203. *Montrose*, 861 P.2d at 1161.

204. *Id.* at 1162. But see *supra* notes 169, 197 and accompanying text.

205. Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 145 (Cal. 1979).

206. *Austero v. National Cas. Co.*, 148 Cal. Rptr. 653, 672 (Ct. App. 1978). See also *Blake v. Aetna Life Ins. Co.*, 160 Cal. Rptr. 528, 542 (Ct. App. 1979) (“Aetna acted reasonably in withholding payment and continuing to investigate. . . . Aetna thereby satisfied both its obligation to the [insured] to act fairly and in good faith and its obligation to other policy holders and to stockholders not to dissipate its reserves through the payment of meritless claims.”).

207. *Native Sun Inv. Group v. Ticor Title Ins. Co.*, 235 Cal. Rptr. 34, 41 (Ct. App. 1987).

208. *Montrose*, 861 P.2d at 1157.

Although these are important interests that the court should strive to protect, they are not the only relevant interests, and therefore should be balanced with other valid concerns. It is not apparent from the court's opinion in *Montrose* whether the court considered the overall effects of its decision, or the valid concerns of the insurance industry, and the long-term interests of other policyholders. If it had, however, it might have, and should have, ruled differently.

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\* The author would like to thank Steve Watson, who suggested the topic, and Dominic Nesbitt, who commented on a portion of the final draft.