WHISTLING PAST THE WASTE SITE:
DIRECTORS' AND OFFICERS' PERSONAL LIABILITY FOR
ENVIRONMENTAL DECISIONS AND THE ROLE OF
LIABILITY INSURANCE COVERAGE

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INTRODUCTION

Federal statutes imposing liability for hazardous waste cleanup costs raise numerous issues directly affecting the personal liability of directors and officers ("D&Os"). The most important issues of concern to D&Os are liability and funding. The liability issue deals with who will bear the cleanup costs; the funding issue deals with how those costs will be financed. Courts have resolved the liability issue with the apparently simple rule that under the Resource Conservation and Recovery Act of 1976 (RCRA)1 and the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA),2 "the 'polluter pays.'"3 The issue of funding, on the other hand, has not been so easily resolved; determining how costs are to be financed often balances on how a court interprets the coverage provided by an insurance contract.

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The problem underlying the funding issue is a basic flaw in the notion that "the polluter pays." Although such a notion is appealing in that it furthers the goals of expediting the cleanup process and reducing the amount of hazardous waste costs borne by taxpayers, it arguably hinders the cleanup process by raising the costs associated with a complicated litigation/settlement process.\(^4\) The strict, retroactive, and joint and several liability of "the polluter pays" notion negates the relevance of cautionary steps taken by individuals. Because strict liability is imposed without regard to willfulness or negligence and retroactive liability is imposed for actions legally acceptable prior to the standard of care established under CERCLA, liability for environmental cleanup approaches absolute liability.\(^5\)

Even those D&Os who are not directly involved in hazardous waste management or chemical industries are potentially liable under CERCLA. The challenges posed by the issue of hazardous waste cleanups are fundamental to almost all applications of the business management process.\(^6\) First, wastes occur at all points in

\(^4\) See Monsanto, 858 F.2d at 176-77 (Widener, J., concurring in part and dissenting in part) (arguing "the vagaries of and delays in ... subsequent suit for contribution might result in needless financial disaster"), cert. denied, 490 U.S. 1106 (1989).

\(^5\) For instance, a safety-conscious generator who keeps exact records and who can show that state of the art techniques were used when 10 barrels of hazardous waste were placed in a 10,000 barrel site might still be held accountable for more of the cleanup costs than an operator who carelessly disposes of 1,000 unsafe barrels in the same site. See, e.g., Joan T. Schmit, *Historical Development and Use of Joint and Several Liability*, 42 CPCU J. 144, 149-50 (1989); see also Monsanto, 858 F.2d at 176 (Widener, J., concurring in part and dissenting in part) (noting the joint and several liability of a small generator that deposited "a few gallons of relatively innocuous waste liquid at a site" for the entire cost of cleanup); William W. Balcke, *Superfund Settlements: The Failed Promise of the 1986 Amendments*, 74 VA. L. REV. 123, 137 (1988) (noting the EPA's "willingness to demand more from responsible parties than their allocable shares of total costs, should it appear that collection of all costs would otherwise be impossible").


\(^6\) See Fredrick D. Sturdivant, *Business and Society: A Managerial Approach*
the production, distribution, and consumption cycle, including the
discovery, recovery, processing, and transportation of raw materials,
the fabrication and assembly of finished products, and the consump-
tion and disposal of those products. Hazardous wastes can be
generated as by-products of manufacturing, released from corpo-
rate equipment (such as factory machinery), and even absorbed
the soil of property acquired for investment by a corpora-
tion. Because waste is so pervasive in industrial activity, busi-
nesses without some nexus to any hazardous waste site are the
exception. Second, hazardous waste is an unintentional by-product
of business enterprise. A chemical perceived as safe by present-


7 See id.

8 See United States v. Northeastern Pharmaceutical & Chem. Co., 810 F.2d 726, 729-30 (8th Cir. 1986) (finding a corporation liable for a disinfectant hexachloro-

gene manufacturing process which produced various hazardous and toxic by-
products), cert. denied, 848 U.S. 848 (1987); Aerojet-General Corp. v. Superior Court, 257 Cal. Rptr. 621 (Cal. Ct. App. 1989) (discussing the release of various toxic
chemicals as by-products of rocket engine and related aerospace product develop-
mant); Michael S. Baram, Chemical Industry Hazards: Liability, Insurance, and the Role
of Risk Analysis, in INSURING AND MANAGING HAZARDOUS RISKS: FROM SEVESO TO
BHOPAL AND BEYOND 415 (Paul R. Kleindorfer & Howard C. Kunreuther eds., 1987)

9 See United States v. Kayser-Roth Corp., 910 F.2d 24, 27-28 (1st Cir. 1990)
(assessing liability for the spillage of hazardous substance used in an industrial
scouring system), cert. denied, 111 S. Ct. 957 (1991); United States v. Carolina
Transformer Co., 739 F. Supp. 1030, 1033-34 (E.D.N.C. 1989) (holding a company
liable for release of PCB-contaminated fluid from electrical transformers). But see
v. Allis Chalmers Corp., 893 F.2d 1313, 1318 (11th Cir. 1990) (finding that makers
of electrical equipment containing PCBs do not necessarily share superfund liability
for cleanup of the hazardous substance when it is later released from the product).

10 See United States v. Monsanto Co., 858 F.2d 160, 168 (4th Cir. 1988) (stating
“[t]he plain language of [CERCLA § 107(a)(2)] extends liability to owners of waste
facilities [as defined in CERCLA § 101(9)(A)-(B)] regardless of their degree of
participation in the subsequent disposal of hazardous waste”), cert. denied, 490 U.S.
1106 (1989); Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 90-92
(3rd Cir. 1988) (finding survivor corporation liable for cleanup of land acquired
through merger), cert. denied, 488 U.S. 1029 (1989); New York v. Shore Realty Corp.,
759 F.2d 1032, 1052 (2d Cir. 1985) (finding the corporate officer/controlling
stockholder liable for CERCLA response costs at known dump site purchased by

9607(b)(3) (1988) (relieving a landowner from initial liability on proof that after “all
appropriate inquiry . . . consistent with good commercial or customary practice” the
landowner still had no reason to know of the presence of hazardous substances).

11 See STURDIVANT, supra note 6, at 313.
day standards, may later engender a long-term hazard to the environment, resulting in long-term liability for those individuals involved in its release. Even a company that performs the most current risk analyses and invests in monitoring costs and state of the art safety precautions cannot shield itself from liability if contamination occurs, or has occurred, due to former practices. Third, the social costs of pollution are not necessarily absorbed by those who enjoy the social benefit of the good producing the hazardous waste by-products. Therefore, without regulatory or market action, risk-creating activities are not internalized by commercial enterprises.

In CERCLA suits, courts have held that common law principles of limited liability for D&Os, traditionally provided by the corporate structure, are not applicable. This loss of common law protection for business decisions is further compounded by judicial interpretations of D&O liability insurance coverage. Unable to deny D&O personal liability because of "the polluter pays" premise, the same courts have also found that D&O liability insurance does not cover insureds' environmental decisions. Indeed, even where the

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13 See supra note 5 and accompanying text.
14 See STURDIVANT, supra note 6, at 315.
15 Even if regulatory action is taken, analyses of problems, approvals from government agencies, and the implementation of plans require significant lead time and start-up costs. See id. at 314.
courts read general liability coverage into D&O liability insurance agreements, their means of finding coverage forebode an unstable body of state common law. Two problems result from these judicial interpretations: first, conventional insurance actuarial techniques in premium setting become inapplicable,\(^{18}\) and second, because of the lack of tenable legal standards to guide decisions, corporate D&Os engage in risk-averse decision making.\(^{19}\)

This Comment traces the development of individual D&O liability and analyzes the public and private sectors' reactions to increased individual liability. Part I of this Comment focuses on sources of liability for environmental decisions, including evolving notions of limited liability under the common law. In reviewing the reasons for common law protection in other areas, the appropriateness of common law limited liability protection for environmental decisions will also be considered. Part I concludes that standards, similar to business judgment rule standards, are warranted for environmental decisions.

If the courts will not provide common law standards to protect the decisions of D&Os in the environmental context, political and market alternatives must be provided. Part II considers the political alternatives to common law protection. State statutory responses, especially in light of their interaction with a federal statute such as CERCLA, will be considered, and the effects of limited liability statutes and the flaws of indemnification statutes will be shown. Part II concludes that state statutory responses to the lack of common law protection are desirable but may not be effective.

Part III analyzes D&O liability insurance as the market alternative to statutory and common law protection. The role of liability

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\(^{19}\) This problem is twofold: the lack of legal standards blurs the threshold of liability, making corporate D&Os more vulnerable to personal liability, while increased claim susceptibility causes the D&O insurance market to respond by restricting coverage availability and increasing coverage costs.

The insurance market's reaction is seen in three separate changes in the availability of coverage: increases in deductible and coinsurance levels, lower aggregate policy limits, and expansion of coverage exclusions. See George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1571 (1987). See generally id. at 1571-76 (discussing how increasing legal risks generated by changes in tort law results in the flight of low-risk insureds from the insurance market, reducing the general availability of affordable insurance).
insurance in protecting D&Os from personal liability under CERCLA will be considered in light of judicial construction of D&O liability insurance coverage. In conclusion, part III suggests that even though the environmental risks associated with CERCLA liability may be insurable, the unstable body of law surrounding both D&O personal liability and the coverage provided by D&O liability insurance are too uncertain for conventional underwriting methods. Without legislative intervention or significant judicial rethinking of the role of insurance and its ability to protect potentially liable D&Os, insurance will not continue to be an effective alternative to the lack of public sector protection. CERCLA's absolute liability scheme provides no incentive for insurers to monitor the decision-making process, for if environmental liability is truly fundamental to the business management process, D&O environmental liability will be uninsurable.

I. DIRECTOR AND OFFICER PERSONAL LIABILITY UNDER CERCLA

Even though CERCLA is the basis for general liability for environmental hazards, it is the federal courts that have created the "evolving principles of federal common law" which impose strict, joint and several, and retroactive personal liability on responsible individuals. These evolving principles of federal common law conflict with state common law limitations on corporate liability. The traditional common law doctrine of limited liability provides that the corporate entity is usually liable for violations of statutes rather than those officers, directors, and shareholders who make up the corporate entity. This common law doctrine of limited liability reflects the uncertainty and risk-taking implicated in every business decision:

Businessmen make business decisions. They are not courts, able and willing to pursue a matter to the last argument in the search of the "right" answer. They are not researchers meticulously seeking truth. They are not scientists striving for ever more refined solutions in a field of narrow specialization. . . . The decisions the businessman must make are fraught with risk, and he is quite accustomed to making these decisions in a hurry on the basis of a hunch and manifestly sparse data. The businessman and the board of directors thrive or die in a sea of uncertainty.

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20 See supra note 3.
22 Bayless Manning, The Business Judgment Rule and the Director's Duty of Attention:
In contrast to the state common law notion of limited liability are developing federal common law notions of individual liability for environmental decisions. In the forum of CERCLA liability, this increased exposure of individual D&Os to personal risk is a result of broad judicial application of CERCLA's liability provisions compounded by heightened judicial standards in determining D&O liability for business decisions.

Since CERCLA imposes civil liability for environmental hazards, whether this liability applies derivatively to D&Os is the fundamental question. "A corporate officer may not be held civilly liable for a corporate violation of [a federal environmental statute] unless either the Act itself authorizes such liability, or there are sufficient allegations and proof to permit negation of the corporate form." When courts choose to apply individual derivative civil liability for corporate environmental violations, they circumvent the fundamental notions of the corporate form and the limited liability doctrine. Such decisions not only are questionable interpretations of statutory provisions, but they are also contrary to the body of law created to protect official decisions made using good business judgment.

Normally, the business judgment rule protects directors from shareholder suits for corporate losses. Similar protection from government suit would protect officers from derivative environmental liability. Such a rule should not protect D&Os who personally

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24 For an example of a court's use of a standard of "gross negligence" to mitigate the business judgment rule, see the celebrated case of Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). See also infra notes 63-73 and accompanying text (discussing the business judgment rule).


27 The business judgment rule provides that the court will not second-guess the merits of a management decision if the five elements of the rule are found: "a business decision, disinterestedness, due care, good faith, and (according to some courts and commentators) no abuse of discretion or waste." DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 2 (3rd ed. 1989).
participate in environmental contamination by making reckless or grossly negligent environmental decisions, but should protect decisions to use the most environmentally safe means available at the time the decision is made. Such a common law rule, similar to the business judgment rule, may counteract the legal environment of increased personal exposure to environmental liability.

A. CERCLA Liability of Directors and Officers: Traditional and Federal Common Law

The courts have generally construed CERCLA as imposing personal liability on individual corporate officers whom the government has chosen to pursue as part of its enforcement strategy. A "person" is liable under section 107 if the government incurs expense for a "release, or a threatened release" of a "hazardous substance." CERCLA provides for four classes of potentially responsible persons (PRPs): (1) current owners or operators of a disposal facility, (2) owners or operators of a disposal facility at the time of disposal, (3) generators of hazardous waste, and (4) transporters of hazardous waste. CERCLA's definitions do not specifically state that corporate D&Os are "owners or operators." Additionally, sections 107(a)(3) and

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28 The reasoning behind holding individual officers liable, however, varies. Compare Gregory P. O'Hara, Minimizing Exposure to Environmental Liabilities for Corporate Officers, Directors, Shareholders and Successors, 6 SANTA CLARA COMPUTER & HIGH TECH. L.J. 1, 5-6 (1990) (claiming that "any person" is the critical term of CERCLA § 107 that "reaches beyond the protection of the corporate shell and attaches liability") with Barnett M. Lawrence, Comment, Liability of Corporate Officers under CERCLA: An Ounce of Prevention May Be the Cure, 20 Envtl. L. Rep. (Envtl. L. Inst.) 10,377, 10,378 (1990) (claiming that the issue is "whether an officer is an 'owner or operator' under CERCLA § 107(a)(2)"). See generally New York v. Shore Realty Corp., 759 F.2d 1032, 1052 (2d Cir. 1985) (using both "owner or operator" and "person" in statutory construction to find individual liability).
30 See id. § 107(a), 42 U.S.C. § 9607(a).
32 Id. § 101(14), 42 U.S.C. § 9601(14).
35 See id. § 107(a)(3), 42 U.S.C. § 9607(a)(3) (defining such a party as "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").
36 See id. § 107(a)(4), 42 U.S.C. § 9607(a)(4) (defining a transporter as "any person who accepts or accepted any hazardous substances for transport").
37 See id. § 101(20), 42 U.S.C. § 9601(20).
(a)(4) do not address management decisions or persons in positions of authority over those persons who may have arranged for disposal, treatment, or transportation of hazardous waste. Therefore, while CERCLA’s liability provisions provide for personal liability, judicial construction is necessary to apply that personal liability to corporate D&Os.

The intention of the Environmental Protection Agency (EPA) to place personal responsibility upon corporate officers and inside directors is evident in the regulation of permit signatories under RCRA. All corporate permit applications must be signed by an officer at the rank of “a president, secretary, treasurer, or any vice president in charge of a principal business function.” Furthermore, permit documents specifically remind the signer of the possibility of fine or imprisonment for deceptive information.

It is not clear whether outside directors fall within CERCLA’s broad liability provisions. Evolving standards of liability, empha-

38 See id. § 107(a)(3)-(a)(4), 42 U.S.C. 9607(a)(3)-(a)(4). It may be argued that the “otherwise arranged for” language of § 107(3) goes to management decisions, but such an argument loses its persuasiveness as the director’s decision, resulting in disposal, treatment, or transportation, becomes attenuated from the actual disposal, treatment, or transportation activity by layers of intervening authority.

39 “[S]tate corporation laws do not distinguish between inside and outside directors,” but “courts and commentators are beginning to look at them differently” for purposes of liability. WILLIAM E. KNEPPER & DAN A. BAILEY, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.09 (4th ed. 1988). Courts will probably look to outside directors’ actions to determine their independence from management. See id. § 1.10.


41 Id. § 270.11(a)(1). The EPA found it necessary to define further the rank of the signator from the original requirement of “a principal executive officer of at least the level of vice-president” under the previous regulation, see 40 C.F.R. § 122.6(a)(1) (1980), to the present requirement, avoiding any misunderstanding that real authority is required. See 48 Fed. Reg. 39,612-13 (1983); see also 45 Fed. Reg. 52,149 (1980) (clarifying 40 C.F.R. § 122.6 (1980)).

42 See 40 C.F.R. § 270.11(d) (1990).

43 If the key term is “any person,” making all individuals liable regardless of the corporate shell, then even outside directors are jointly and severally liable for their participation on the board which makes the decision. See CERCLA, § 107 (a)(2)-(a)(4), 42 U.S.C. § 9607(a)(2)-(a)(4) (1988); O’Hara, supra note 28, at 6 (stating that the significance of the term “any person” is that it reaches beyond the corporate shell attaching liability to any individual or corporation fitting within the class made potentially liable). If, however, the definition of “owner or operator” is equally important, then broad construction of that phrase may determine that participation in management of a “facility” as an “operator” is not equivalent to participation in management of a corporation as a fiduciary, and without any indicia of ownership the outside director is excluded from liability for his corporate decisions. See CERCLA, § 101(9), (20)(A), 42 U.S.C. § 9601(9), (20)(A) (1988); see also, Lawrence, supra note
sizing control or authority, make it unlikely, however, that a court will fail to find an outside director liable for her relationship to business decisions affecting the facility. As was articulated above, courts often read into CERCLA a congressional intention to find corporate D&Os individually liable for their environmental decisions. However, courts must also bypass the common law notions of limited liability protecting management decisions. The courts must, therefore, create common law to justify an imposition of personal liability on D&Os, for they cannot merely rely on the language of CERCLA.

Under traditional common law, even though a corporation may be strictly liable for the consequences of a management decision, the mere holding of corporate office does not in and of itself make the officer personally liable for management decisions. Corporate officers are protected by a "fiduciary shield." This fiduciary shield is not, however, impenetrable. Under a common law "personal participation" theory, a corporate officer can be held directly liable for the corporation's torts. To be held directly liable, the officer must have personally participated in the tortious activity. Under the personal participation theory, an officer is personally liable for any wrongful acts she commits, even those committed on behalf of the corporate employer and within the scope of her duties. This theory has been given liberal effect by

28, at 10,378 (concluding that the broad standard of liability is consistent with CERCLA's purposes and is good policy).

44 See Lawrence, supra note 28, at 10,380-81 (identifying a line of cases finding individual responsibility for day-to-day management and operations to be grounds for liability).

45 See United States v. Kayser-Roth Corp., 724 F. Supp. 15, 21 (D.R.I. 1989) (noting that precedent exists in which a "stockholder, parent corporation, or any person associated with a facility whether he or she has any ownership interest or not, may be held liable if that person...controls the management and operation of the polluting corporation"), aff'd, 910 F.2d 24 (1st Cir. 1990), cert. denied, 111 S. Ct. 957 (1991).


47 See BLOCK ET AL., supra note 27, at 29.

48 See Escude Cruz v. Ortho Pharmaceutical Corp., 619 F.2d 902, 907 (1st Cir. 1980) (stating that, as a general rule, personal participation includes "[s]pecific direction or sanction of, or active participation or cooperation in, a positively wrongful act of commission or omission" (quoting Lobato v. Pay Less Drug Stores, 261 F.2d 406, 408-09 (10th Cir. 1958)); see also United States v. Northeastern Pharmaceutical & Chem. Co., 810 F.2d 726, 744 (8th Cir. 1986) (comparing derivative liability premised upon defendant's status as a corporate officer with personal liability for actual participation in the tort), cert. denied, 484 U.S. 848 (1987).

49 See 3A WILLIAM M. FLETCHER, FLETCHER Cyclopedia of the Law of Private
some courts and has been applied in the environmental context to impose both civil and criminal liability on corporate officers. It is, however, a theory that is based on direct liability for the wrongful act of the officer, and is different from the major concern of CERCLA liability—that personal derivative liability will result from a business decision taken with due care.

Derivative liability is not a normal means of finding personal civil liability in the corporate context. Derivative liability of corporate officers is usually found in criminal cases in which a criminal statute “imposes the highest standard of care and permits conviction of responsible corporate officials who . . . have the power to prevent or correct violations of its provisions.” Although corporate officers have been held derivatively liable for criminal


50 For example, as one court observed:

To be held directly liable as an operator, courts have considered a number of factors including: whether the person or corporation had the capacity to discover in a timely fashion the release or threat of release of hazardous substances; whether the person or corporation had the power to direct the mechanisms causing the release; and whether the person or corporation had the capacity to prevent and abate damages. United States v. Carolina Transformer, Co., 799 F. Supp. 1030, 1038 (E.D.N.C. 1989). None of these factors indicates the level of culpability to be considered. Carolina Transformer is arguably an easy case—the officers were aware of the environmental problem, but “took no actions to correct the problem or change the work habits of employees”—evidencing gross negligence. Id. A standard of gross negligence would comport with the common law. See Smith v. Van Gorkom, 488 A.2d 858, 878 (Del. 1985) (stating that director liability is based on concepts of gross negligence). CERCLA, however, imposes strict liability. See supra note 3. Strict liability for corporate decisions does not accord with the business judgement rule. See infra notes 63-73 and accompanying text (discussing the business judgment rule).


violations of environmental laws, courts are less likely to impose derivative civil liability on corporate officers.

Because of the different risks of personal liability between direct and derivative civil liability, a perplexing concern for corporate officers must be whether a decision regarding a corporation’s hazardous materials will be evaluated by the EPA and the courts as personal participation in a wrongful act. This uncertainty is compounded by the knowledge that, if they are liable individually, their individual liability will be joint and several with other PRPs for the cleanup costs, even if they used the most conservative decision-making process.

In addition to the traditional common law theories that support the imposition of personal liability on D&Os, courts can also turn to federal common law. Under the federal common law there are at least two additional approaches that can be used to impose personal liability on D&Os. In the CERCLA context, the most common approach is to “look to the language and purpose of the statute in determining whether Congressional intent favors protection of the corporate form.” CERCLA liability decisions applying such an approach are inconsistent with one another; congressional intent has been read both for and against imposing personal liability. A second federal common law approach is a heavily fact-specific “prevention test.” This approach was intro-

53 See United States v. Johnson & Towers, Inc., 741 F.2d 662, 670 (3d Cir. 1984) (finding knowledge of RCRA violations could be inferred to corporate defendants in positions of responsibility in order to hold them criminally liable), cert. denied, 469 U.S. 1208 (1985); Frezzo Bros., 609 F.2d at 1124 (finding individual defendants liable as responsible corporate officers).

54 See Pollution Abatement Servs., 763 F.2d at 134-35 (distinguishing United States v. Sexton Cove, 526 F.2d 1293, 1300-01 (5th Cir. 1976), which construed an analogous environmental statute as precluding civil derivative, as opposed to personal, liability).

55 See supra notes 3 & 5.

56 O’Hara, supra note 28, at 4-5; see also Town of Brookline v. Gorsuch, 667 F.2d 215, 221 (1st Cir. 1981) (indicating that courts applying federal common law “will look closely at the purpose of the federal statute to determine whether the statute places importance on the corporate form, an inquiry that usually gives less respect to the corporate form than does the strict common law alter ego doctrine” (citations omitted)).

duced and applied in *Kelley v. Thomas Solvent Co.* and *Kelley ex rel. Michigan Natural Resources Commission v. ARCO Industries.* In both cases, the court based its test on a finding that "[a]lthough liability under CERCLA is essentially a strict liability scheme, the case law indicates that where CERCLA seeks to impose liability beyond the corporate form, an individual's power to control the practice and policy of the corporation, and the responsibility undertaken by that individual . . . should be considered." At the very least, such a test allows corporate D&Os to prove that the practices used and individual precautions taken to prevent the release of hazardous substances meet a threshold standard of care. By meeting such a standard, individual D&Os would avoid joint and several liability with other PRPs for accidental releases of hazardous substances. Such a standard reflects the traditional common law notions underlying the business judgment rule. The prevention test, therefore, reflects the uncertainty involved in many corporate decisions that have potential environmental effects and promotes responsible decision-making.

Nevertheless, more conclusive theories for imposing personal liability on D&Os may be evolving under the federal common law. For instance, a federal common law theory of individual liability called the "central figure" theory has been applied in cases dealing with violations of domestic fuel price controls. Under this theory, the person who played the "central role" in corporate wrongdoing is fully liable. The question of whether the defendant played a central role is based on a fact-specific analysis of her role and actions. According to the central role theory, the defendant may be held liable even if she did not participate in the actual commission of the tort.
B. Establishing a Standard of Care For Environmental Decisions

In the corporate context, D&Os owe a fiduciary duty to shareholders of their corporation. That duty consists of a duty of loyalty and a duty of reasonable care. If D&Os breach that duty, they are susceptible to shareholder suits. Should such a suit arise, D&Os, in defending their actions as fiduciaries, can rely on the business judgment rule. The business judgment rule protects D&Os from liability for corporate losses caused by honest mistakes of judgment; it presumes that D&Os have complied with their fiduciary duties. Even where that presumption is contested, D&Os are protected from judicial second-guessing of their business decisions if such decisions are made while exercising due (or ordinary) care, acting in good faith, and having a reasonable belief that the actions are in the corporation's best interest. The rule is an efficient one. Based on the theory that some risk-taking is desirable in maximizing corporate profitability, the business judgment rule reduces disincentives for good faith risk-taking by limiting D&Os' liability.

Although the business judgment rule protects D&Os from judicial second-guessing when defending against shareholder suits, similar protection may not be available for environmental decisions resulting in potential CERCLA liability. First, the rule is only applicable when the cause of action is based on the breach of a fiduciary duty and when D&Os act lawfully. Thus, the rule

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65 See BLOCK ET AL., supra note 27, at 1; KNEPPER & BAILEY, supra note 39, § 1.04.
66 See BLOCK ET AL., supra note 27, at 2-3; see also REVISED MODEL BUSINESS CORP. ACT § 8.30 (1984) (codifying the business judgment rule as a standard of conduct). The rule has been codified as a general standard of conduct for directors in a majority of the states. See, e.g., CAL. CORP. CODE § 309(a) (West 1990); N.Y. BUS. CORP. LAW § 717 (McKinney Supp. 1991).
68 But see supra notes 58-60 and accompanying text (commenting that the prevention test applied by the United States District Court for the Western District of Michigan approximates a business judgment rule standard).
69 See KNEPPER & BAILEY, supra note 39, § 6.02 ("[The rule] has no role where
would not apply in a case where management fails to disclose adequately information regarding environmental risk-taking or potential environmental problems to investors as required by federal securities laws.\footnote{See Leigh v. Engle, 727 F.2d 113, 125 (7th Cir. 1984) (discussing the actions of pension fund directors in terms of the fiduciary duties imposed by the Employment Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (1988)).}


In 1989, the SEC clarified its environmental disclosure requirements in an interpretive release. See Management’s Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release Nos. 33-6835; 34-26831; IC-16961, 54 Fed. Reg. 22,427, 22,430 (1989) [hereinafter MD&A Release]. Essentially, there are four major types of environmental contingencies that may require disclosure: (1) if compliance with “command and control” environmental law requirements (such as installation of pollution control equipment) may have a material effect on a registrant; (2) if initiation or potential initiation of toxic tort litigation is likely to have a material effect; (3) if past corporate environmental practices by the registrant make it reasonably likely that remediation for those practices is necessary; and (4) if the registrant is connected with a facility at which cleanup activities may impose potential liability. See Archer et al., supra, at 10,108.

Although the SEC has stated that designation as a PRP by the EPA under CERCLA “does not in and of itself trigger disclosure, . . . a registrant’s particular circumstances, when coupled with PRP status, may provide that knowledge.” MD&A Release, supra, at 22,430 n.30.

Thus, negligence in failing to disclose or in improperly disclosing the potential environmental liabilities of the corporation in a registration statement will result in personal civil liability of corporate directors and signing officers under § 11 of the Securities Act of 1933, 15 U.S.C. §§ 77f, 77k (1988). The SEC does not, however, provide specific standards for investigation or exact quantification of the liability. See, e.g., Diana B. Henriques, Tracking Environmental Risk, N.Y. TIMES, Apr. 28, 1991, at F13 (reporting that although the SEC warned companies in 1989 to disclose any potential environmental liabilities under CERCLA, the SEC still “relies strongly on the company’s own opinion of materiality. So most of the [10-K liability disclosures] do not disclose very much.” (quoting Anthony J. Buonicore)). Additionally, the EPA and the SEC have an informal arrangement whereby the EPA provides the commission with names of companies receiving PRP letters and other information on pending cases and complaints. See Conference Report: Environmental Issues Seen as Having Ever-Widening Impact on Corporate America, 5 B.N.A.'s CORP. COUNS. WEEKLY 6 (spec. supp. June 20, 1990) (statement of William E. Morley, associate director of SEC's Division of Corporate Finance).

Although § 11 is a potential source of personal liability for D&Os, § 11 damages are limited to a maximum recovery equal to the price at which the securities were offered to the public. See Securities Act of 1933, §33, 15 U.S.C. § 77k(e), (g) (1988). These compensatory damages may be minor compared to the potential long-range costs of the underlying environmental damages. They are, nevertheless, a potential liability for the entire board, including the outside directors.
Let us then consider the normal situation of a director who has made a good faith environmental decision, such as deciding to use the best available means for containing and disposing of hazardous wastes. Under the business judgment rule, the director would expect that if the best available means accord with industry standards and CERCLA liability results regardless of those best available means, he will still be protected from shareholder suits. Therefore, although a director is not liable to the corporate shareholders for the corporation's share of the costs, he may have strict personal liability to the government for cleanup costs regardless of the standard of care used by the director. Such a result makes sense, for unlike the government, the shareholders have, in theory, assumed the risk that management decisions may result in losses to the corporation.

That the director's best-available-means environmental decision is not protected from CERCLA liability by a rule similar to the business judgment rule would not normally be a problem because he is normally protected from derivative liability by common law limited liability standards. Courts, however, have removed limited liability protection by finding individual liability for corporate managers to be a necessary means of accomplishing the congressional intent behind CERCLA. Additional indirectly

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72 See Briggs v. Spaulding, 141 U.S. 132, 152 (1891) (stating that with respect to the corporation, the director is bound to the degree of care of an "ordinarily prudent and diligent man... under similar conditions," taking into account usages of business); see also KNEPPER & BAILEY, supra note 39, § 1.14 (stating that the liability of corporate D&Os to indemnify their corporation is not based on any concept of comparative negligence, but on the wrong that caused the injury and the nature of the legal obligation (citing Builders Supply Co. v. McCabe, 77 A.2d 368 (Pa. 1951))).

73 Therefore, although the business judgment rule may be of little help to directors in avoiding personal liability to the government for cleanup costs, it is at least of some benefit in defending against shareholder suits that may arise over corporate liability for CERCLA expenses. This protection against shareholder suits is particularly important if D&O liability insurance policy claims are to be a reasonable view of reality: according to a Wyatt Company survey of D&O insurance, shareholders were the single largest source of D&O policy claims. See THE WYATT COMPANY, 1989 WYATT DIRECTORS AND OFFICERS LIABILITY SURVEY 37-38 (1989); cf. Julie J. Bisceglia, Comment, Practical Aspects of Directors' and Officers' Liability Insurance—Allocating and Advancing Legal Fees and the Duty to Defend, 32 UCLA L. REV. 690, 692 (1985) (stating "claims covered by this [D&O] policy resemble plane crashes, infrequent but devastating"). But cf. THE WYATT COMPANY, 1988 WYATT DIRECTORS AND OFFICERS LIABILITY SURVEY 25, 27 (1988) (finding that only .1% of claims during the period 1979-1987 were environmental and that no environmental claims appear to have been initiated by shareholders).

74 See supra notes 52-54 and accompanying text.

75 See supra notes 56-57 and accompanying text.
related problems, such as securities regulations, which require reporting of potential environmental problems, further increase this individual risk.\textsuperscript{76} If courts do not restore common law protection to D&Os' decisions, such as business judgment rule presumptions, the risk of increased exposure to personal blame and decreased personal protection will cause managers—who are least likely to be able to shift the burden of risk\textsuperscript{77} to "fail conservative," avoiding personal liability by refusing to take risks, even to the detriment of corporate profitability and success.\textsuperscript{78}

II. THE UNCERTAIN RESULTS OF STATE LEGISLATIVE ATTEMPTS TO LIMIT THE PERSONAL LIABILITY OF DIRECTORS AND OFFICERS

There are three possible responses to D&O liability under CERCLA: (1) D&Os can refuse to make decisions entailing personal risk of environmental liability, (2) legislatures can provide additional statutory protection against personal D&O liability, or (3) the market can respond by shifting the risk of personal loss to the beneficiaries of the risk.

The individual response by D&Os will not work if the risk of pollution liability is universal and absolute, and there are strong grounds to believe this is substantially true.\textsuperscript{79} The legislative response will work only if it really removes the risk from the individual. State legislatures have a definite interest in protecting corporate decision-makers. Corporate D&Os will seek to do business in states where their personal interests are best protected. Thus, states must respond by doing all they can to restore confidence, or risk losing qualified corporate managers (or entire corporations) to states providing more favorable treatment of corporate decision-makers.\textsuperscript{80} This part addresses the legislative response alternative; the market response alternative is addressed in part III.

\textsuperscript{76} See supra note 71.
\textsuperscript{77} See Easterbrook & Fischel, supra note 21, at 116.
\textsuperscript{78} See Sara R. Slaughter, Note, Statutory and Non-Statutory Responses to the Director and Officer Liability Insurance Crisis, 63 Ind. L.J. 181, 185 (1987) (arguing that if no indemnification or insurance is available, directors may avoid all risks).
\textsuperscript{79} See supra notes 5-13 and accompanying text.
\textsuperscript{80} See Knepper & Bailey, supra note 39, § 7.01 (discussing legislative efforts in Delaware and Ohio to limit liability of corporate directors).
A. State Statutory Limits on Liability


Notably, however, while most state statutes protect directors, they do not extend their coverage to officers. See e.g., CAL. CORP. CODE § 309 cmt. (West 1990); see also DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1990) (including directors, but not specifically including officers under its coverage); Gilchrist Sparks III, Delaware's D&O Liability Law: Other States Should Follow Suit, LEGAL TIMES, Aug. 18, 1986, at 10 (stating that the drafters did not feel "that the increased perception of risk of personal liability . . . was sufficient to cause officers, who depend upon a corporation for their livelihood, to resign or refuse to serve"); Slaughter, supra note 78, at 186-90 (discussing the Delaware statute and how it has been followed in many states). In such cases, the individual officer's only protection is D&O liability insurance, and even insurance may not provide protection for environmental decisions. See infra notes 101-67 and accompanying text (discussing D&O liability insurance).

See, e.g., OHIO REV. CODE ANN. § 1701.59(D) (Anderson 1985 & Supp. 1990) (preventing liability without proof that director acted with deliberate intent or reckless disregard); TEX. BUS. CORP. ACT ANN. art. 2.41(D) (West 1980 & Supp. 1989) (preventing liability from any claims or damages if director acted in good faith, with ordinary care, and in reliance upon written opinion of an attorney for the corporation).

CAL. CORP. CODE § 309(a), (c) (West 1990).
Courts have held that "federal common law rather than state law determines the availability of an action for contribution against parties that are liable under CERCLA." However, the cases in which this issue has arisen do not provide precedent for situations where an individual director is charged with derivative CERCLA liability and statutory limits of individual liability exist. Careful analysis of cases commonly cited to support strict liability of individual directors reveals that more than owner or operator status is actually considered in finding strict individual liability; personal participation in the pollution activity falling below a due care standard is the primary consideration.

Thus, the same cases that are primarily used by the courts to support a finding of strict individual liability under the federal environmental laws, can also be used in contrast to support the effectiveness of a state statutory limitation on liability for decisions meeting a statutory standard of due care. The result, that directors are protected from individual liability in states where such statutory protection exist, reflects the belief that directors should not be guarantors of the corporation when an established standard of conduct is observed.


85 See, e.g., United States v. Northeastern Pharmaceutical & Chem. Co., 810 F.2d 726, 729-30, 743-45 (8th Cir. 1986) (finding that though the director was strictly liable his omissions in determining or influencing the control of hazardous waste disposal would probably not meet a due care standard), cert. denied, 484 U.S. 848 (1987); New York v. Shore Realty Corp., 759 F.2d 1032, 1039, 1052 (2d Cir. 1985) (finding director strictly liable, but also citing evidence showing efforts to abate pollution not likely to meet a due care standard). See generally Kelley v. Thomas Solvent Co., 727 F. Supp. 1554, 1562 (W.D. Mich. 1989) (articulating a due care standard based on a degree of authority and responsibility undertaken to determine "whether the individual in a close corporation could have prevented or significantly abated the release of hazardous substance[s]").

86 See supra note 3.


88 Cf. Cort v. Ash, 422 U.S. 66, 84 (1975) (refusing to create a federal private right of action for allegedly illegal corporate campaign contributions and holding that "[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will
Additionally, at least four courts have ruled on the question of CERCLA preemption of state corporation laws. The decisions are split on whether the federal policy behind CERCLA is intended to hold parties liable under CERCLA, even if liability for cleanup costs is in conflict with state capacity statutes. This important question was recently denied review by the United States Supreme Court following the Eighth Circuit’s rejection of the argument that preemption of state laws by CERCLA is essential to ensure that liable parties do not use state corporation laws as a shield. It is therefore probable that in a state where the statutory standard of conduct for corporate directors requires gross negligence or recklessness for personal liability, a suit for CERCLA damages against an individual corporate director will not be sustained based purely on derivative strict liability.

89 See Onan Corp. v. Industrial Steel Corp., No. 89-5387 (8th Cir. June 5, 1990), cert. denied, 111 S. Ct. 431 (1990); Levin Metals Corp. v. Parr-Richmond Terminal Co., 817 F.2d 1448, 1451 (9th Cir. 1987) (finding that CERCLA does not preempt state capacity statutes); Columbia River Serv. Corp. v. Gilman, 751 F. Supp. 1448, 1453 (W.D. Wash. 1990) (holding that CERCLA does not preempt state law in determining capacity to be sued); United States v. Sharon Steel Corp., 681 F. Supp. 1492, 1498 (D. Utah 1987) (holding that CERCLA preempts state capacity statute). The Eighth Circuit held, in Onan Corp., that CERCLA does not preempt state capacity statutes. See Gilman, 751 F. Supp. at 1450 (discussing the unreported Onan Corp. decision).

90 See Gilman, 751 F. Supp at 1450-53 (surveying state and federal decisions on whether CERCLA preempts state statutes).

91 See High Court Presented With Pre-Emption Case Raising CERCLA Liability For Dissolved Firm, 21 Env’t Rep. (BNA) 1178 (Oct. 19, 1990) (reporting on the history of Onan Corp.).

92 See supra notes 82-83 and accompanying text (discussing some statutory standards).

B. State Indemnification Statutes

The statutory limitations on corporate directors' liability, discussed above, exist only in a few states. Most states' corporation laws provide only permissive protection, which allow their corporations—competing in the marketplace for corporate managers—to decide whether or not to provide management with indemnification provisions in the corporate charter or bylaws. Furthermore, such statutes are unlikely to address (let alone provide for) corporate indemnification of a director's or an officer's personal liability to the federal government or other third parties. A director or officer in such states is, therefore, probably not required to be indemnified by his corporation for personal CERCLA liability to the federal government.

Additionally, the lack of business judgment rule protection for D&Os from personal liability for CERCLA cleanup costs means D&Os are most likely to be held personally accountable to the federal government in the very area in which they are least likely to enjoy indemnification. Though the benefits D&Os receive may reflect their risks of liability, few individuals can afford the costs of litigation and cleanup associated with CERCLA liability, regardless of salary, compensation, and other prerogatives. In addition, the argument that D&Os should be personally accountable to the government as "operators" of the corporation seems prejudicial against the management role. The corporation is operated for the benefit of the shareholder-owners who enjoy the statutory protection of CERCLA's exclusion of persons holding "indicia of ownership, . . . without participating in the management of a facility." Thus, by the interaction of environmental and corporate statutes, D&Os retain a significant risk of personal liability with no statutory requirement for corporate indemnification of such liability.

Statutory indemnity will not entirely remedy the dilemma of personal risk if interim funding of litigation and expenses is only

94 See supra notes 82-83 and accompanying text.
95 See BLOCK ET AL., supra note 27, at 567-68.
96 Indeed, officers may not even be addressed by indemnification statutes. See supra note 81.
97 See DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1990) (addressing only "liability . . . to the corporation or its stockholders"); FLA. STAT. ANN. § 607.0851 (West Supp. 1991) (limiting liability "to the corporation or any other person" only); WIS. STAT. § 180.0828(1) (1991) (same).
When interim funding is not specifically mandated in the corporate by-laws, the burden of advancing the costs of litigation and expenses may fall on the individual, who may not be repaid under the indemnity contract until entry of a final favorable ruling. This burden treats the individual as a wrongdoer until her acts have been legally vindicated.

The purpose of CERCLA is to ensure compensation of the government and private groups for the cost of hazardous waste cleanup, not to punish decision-makers for past actions that violate current standards. There is, therefore, no public policy reason for forcing a corporate director or officer to bear the burden of proving that her actions warrant indemnification. D&Os who commit clearly wrongful acts should expect no protection, but where liability is strict and retroactive the line between right and wrong is blurred. This lack of a "bright line" standard makes it inequitable to force an individual to bear the burden of defending her good faith/best judgment risks taken for the benefit of the corporation and its shareholder-owners until, through vindication, indemnification is warranted.

The risk of personal liability for corporate D&Os can be partially remedied if, when using good faith and their best judgment in making decisions, D&Os are protected from personal liability for unforeseen or unappreciated risks until the reasonableness of their decisions is disproved. Statutory indemnification does not provide such protection. Individual liability insurance coverage could provide this protection as a market response to the uncertainties of indemnification and the burden of CERCLA interim costs, but for insurance to be an effective market tool, courts must keep the

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99 For examples of statutes in which interim funding of litigation and expenses is only permissive, see DEL. CODE ANN. tit. 8, § 145(c) (Supp. 1990); IND. CODE § 25-1-37-8(a) (1989); NEV. REV. STAT. § 78.751(4) (1986 & Supp. 1989); N.Y. BUS. CORP. LAW § 723(c) (McKinney Supp. 1991); 15 PA. CONS. STAT. ANN. § 512 (1990); Wis. STAT. § 180.046 (1991).

100 See 11 GEORGE J. COUCH ET AL., COUCH CYCLOPEDIA OF INSURANCE LAW § 44:4 (2d ed. 1982) (discussing distinction between liability and indemnity coverage); 3A FLETCHER, supra note 49, § 19:44 (perm. ed. rev. 1986) (noting indemnification payments cannot be made until after the court has made a final determination).


102 See supra notes 48-53 and accompanying text.
nature of the negotiated risk in mind when they analyze what was bargained for in the D&O policy. Unfortunately, as part III will show, the courts have either not realized the nature of the negotiated risk or have gotten their analysis of D&O liability policy coverage wrong in attempting to cover the negotiated risk.

III. DIRECTOR AND OFFICER LIABILITY INSURANCE AND INDIVIDUAL CERCLA LIABILITY: JUDICIAL INTERVENTION IN THE INSURANCE MARKET

A. The Need for Liability Insurance

The purpose of the first two parts of this Comment was to show that under the current state of the law D&Os remain vulnerable to CERCLA's provisions imposing strict and retroactive liability for unforeseen and inappreciable risks. Numerous externalities exist which can transform reasonable business decisions, taken in good faith, into wrongful acts of environmental contamination. States have generally attempted to reduce the exposure of D&Os to personal risk with statutory limits on liability and statutory indemnification. Federal court decisions finding that state corporation laws are not preempted by CERCLA's liability provisions indicate judicial support for state statutory limitations on D&O liability. In those states, however, where permissive indemnification is the only protection for D&Os from CERCLA liability, the statutory protection is incomplete.

Incomplete protection means that there is a substantial risk of personal liability for D&Os. Market measures are therefore necessary to compensate for this lack of protection. Pollution liability insurance is one such market mechanism. Liability insurance requires that the insurer provide coverage once a liability has been established; the fact that the insured has not yet suffered any loss is immaterial. Liability insurance, therefore, insulates D&Os from the cost of personally warranting their actions and thus approaches a better remedy than statutory indemnification.

D&O liability insurance (either through a commercial carrier or private self-insurance) shifts the burden of risks taken in good faith

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103 See supra notes 89-93 and accompanying text.
105 See 11 COUCH ET AL., supra note 100, § 44:4.
and using best judgment back to the real beneficiary of the risks, the shareholder-owners. Insurance coverage forces the shareholders to convert potential returns into insurance premium payments. Shareholders may respond to this shifting of the risk by arguing that the threat of individual liability can be shown to have a very real effect on the decision-maker who is potentially exposed to personal loss, and by thus shifting the risk of personal loss away from management, standards of managerial conduct will diminish. Nevertheless, when D&Os are acting for the corporation the business judgment rule requirements (which protect against the more real threat of shareholder suits) should maintain a minimum standard of management conduct.

B. Judicial Disregard for the Justification Behind D&O Liability Policies

Statutory limitations on liability represent a public policy that D&Os should not be personally liable for corporate acts taken in good faith and using reasonable judgment. D&O liability insurance represents a similar market response to such liability by providing insurance for the risk associated with business decisions that result in personal liability. However, such a market mechanism can be effective only if courts correctly analyze the insurance agreement and the intentions of the parties creating the agreement.

A D&O liability insurance policy comes in two parts. One part provides insurance directly to the individual; the other part provides reimbursement to the corporation for executive indemnification. The individual insurance coverage and the corporate indemnification insurance coverage are always provided by the same D&O liability insurance policy. Although the overall policy is titled

106 Alternatively, the corporation may choose to self-insure and spread such risks through risk pools or captive insurers, or simply choose to absorb the loss. See Block et al., supra note 27, at 619.

107 This was especially obvious during the D&O liability insurance crisis of 1986. See Slaughter, supra note 78, at 184-85 (reporting incidents of directors resigning when insurance ended).


109 See supra note 27.

110 See Block et al., supra note 27, at 482-83.

111 For examples of current D&O policies provided by the two leading carriers, see Chubb Group of Insurance Companies, Executive Liability and Indemnification Policy, Chubb Form 14-02-0386 (Ed. 2-84) (1984) [hereinafter "Chubb Policy"], and National Union Fire Insurance Company of Pittsburgh, Pa., Directors and Officers Insurance and Company Reimbursement Policy, National Union Forms 47352 &
a "liability" policy, there is disagreement as to whether the insurance policy really provides liability insurance. Since the corporation reimbursement part of the policy provides indemnification coverage to the corporation, insurers argue that the entire policy (including the individual insurance part) is an indemnity policy.112 This argument does not reflect the obvious intent of the D&O insureds in seeking D&O liability insurance for personal liability.113 The D&O insureds are primarily interested in creating a liability policy that avoids the personal expenses associated with indemnification.

Remembering the problems associated with the common law and state indemnification statutes which justify D&O liability insurance as a supplemental market measure,114 the reason for the bifurcation of D&O liability policies seems plain. As was discussed in part II, indemnification is an imperfect guarantee of personal risk.115 The corporate indemnification portion of the policy reimburses the insured corporation for this partial protection of D&Os permitted by indemnification statutes. If D&O liability insurance is to be a market response to the partial protection of indemnification, the individual insurance portion of the policy must exist to alleviate the remaining financial burdens associated with indemnification: the costs of litigation and CERCLA response costs incurred prior to a favorable ruling.116

1. Facile Construction of D&O Policies Disregarding the Market Role of Insurance

Regardless of the inherent nature of insurance as a market response and the plain purpose of D&O liability insurance as manifested by the bifurcated policy, courts have used other reasoning in their determinations of whether a D&O policy provides

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47353 (1988) [hereinafter "National Union Policy"] (on file with the author).
112 The insurance carrier prefers that the policy be an indemnity policy, because the burden is then upon the insured to prove the wrongful act is covered by the policy.
113 An important concern for the individual D&Os in performing a personal risk analysis of their decisions is whether their D&O liability policy provides liability or indemnity coverage. See, e.g., Bisceglia, supra note 73, at 691 (discussing the practical effect of the difference between indemnity and liability policies for D&Os).
114 See supra notes 95-102 and accompanying text (discussing state indemnification statutes).
115 See supra notes 95-102 and accompanying text.
116 For a discussion of response costs that may be incurred before a favorable ruling, see infra note 139.
liability coverage. The first and far more superficial approach is to simply look at the title and the loss provisions of the policy. Such a determination has little support because it disregards the policy as a whole. A better approach is to look at the entire policy as well as the market need to which the insurance policy is responding. Armed with both the negotiated terms of the policy and the parties' primary purposes, courts can then resolve policy ambiguities that manifest the distinct expectations of the parties to the insurance agreement. Ambiguities contrary to the intentions of the insureds should be resolved in favor of liability coverage. Generally, however, judicial analyses fail to consider both the entirety of the D&O policy and its purpose in providing reasons for finding liability or indemnity coverage.

The fault, however, may not lie with the court, but with the insureds. Insureds continue to make the *ipse dixit* argument that D&O policies are customary liability policies because the title—regardless of the market uncertainty driving D&Os to seek liability insurance and the entire policy contents—labels the policy as a "liability" policy. Carriers correctly argue that their actual intention is to provide indemnity coverage. Fortunately for the insureds making the *ipse dixit* argument, several courts have endorsed their reasoning (or lack thereof).

117 See *Restate ment (Second) of Contracts* § 203 (1979) (stating contractual terms are to be interpreted in such a way that they are given a "reasonable, lawful, and effective meaning," over an "unreasonable, unlawful" or ineffective meaning). Certainly, the title of a policy—a "liability" policy—if merely a customary way of referring to such a policy is standardized language and courts should look more carefully at the contents of the policy.

118 See id. § 202(1) (stating that the primary purpose of the parties, if ascertainable, should be given great weight). It is arguable that the "liability" title indicates the primary purpose of the parties is to create a liability policy.

119 See id. § 206 (stating that ambiguous terms shall generally be construed against the drafter).

120 Compare Zaborac v. American Casualty Co., 663 F. Supp. 330, 332 (C.D. Ill. 1987) (finding the policy was an indemnification policy and stating "the [insurer's] obligations do not accrue until the loss suffered by the insured can be ultimately determined, which is at the time the underlying claims are adjudicated or settled") with FSLIC v. Burdette, 718 F. Supp. 649, 661 (E.D. Tenn. 1989) (noting that insurance policies must be read as a whole and determining that, based on the title of the policy and its loss provisions, the policy was a liability policy). See generally 11 COUCH ET AL., supra note 100, § 44:4 (distinguishing indemnity and liability insurance); ROBERT E. KEETON, BASIC TEXT ON INSURANCE LAW § 4.8(a) (1971) (stating that liability insurance protects the insured against loss caused by his tort liability to a third person).

121 See KNEPPER & BAILEY, supra note 39, § 21.08 (D&O insurance policies "are, and always have been intended to be, 'indemnity' or reimbursement policies").

122 In Okada v. MGIC Indemnity Corp., 823 F.2d 276 (9th Cir. 1987), the Ninth
Indemnity Corp.\textsuperscript{123} provides a good example of judicial analysis along these lines:

We begin by noting that, as its title plainly indicates, the policy is a liability policy rather than an indemnity policy. . . . The language of [the loss provision] is entirely consistent with the characterization of the policy as a liability policy. A “loss” is defined as an amount that the insured is “legally obligated to pay.” Although this section does not explicitly speak to the timing of the insurer’s duty to pay, the only reasonable interpretation is that this duty arises at the time the insured becomes “legally obligated to pay.”\textsuperscript{124}

The court’s reasoning is tautological. The court looks only to the title and the loss provisions of the policy. In order to find that to be the “only reasonable interpretation,” the policy must be read as a liability policy in the first place. Because the policy is silent as to timing, the court should have looked elsewhere in the policy, and if that was not sufficient, to the purposes of the policy as a whole.

Treating a policy as a liability policy simply because of the name on the title page and a facile reading of the loss provision fails to consider the intentions of the parties to the agreement. Such an approach only manifests a judicial preference for insurers to pay the costs of litigation as they are incurred, regardless of whether such an obligation is intended.

Furthermore, such an analysis is not a persuasive foundation on which to support future decisions. It is too easy for insurers to point at such decisions as gestures of judicial activism by the courts. Judicially shifting cleanup costs to the insurer in such a cursory manner only shifts the potential absolute liability to the insurer without regard to whether that is the purpose of the agreement. Therefore, superficial judicial construction of insurance agreements manifests an inequitable treatment of insureds and insurers, and places the highly correlated risk of environmental liability on the insurer.\textsuperscript{125} This partiality for a perfunctory construction of the

\textsuperscript{123} 836 F.2d 789 (3d Cir. 1987).
\textsuperscript{124} Id. at 799.
\textsuperscript{125} See generally Priest, supra note 19, at 1544-48 (discussing the necessity, in
insurance agreement cannot be cured by better policy drafting, but only by the loss of insurance availability.126

2. Failure of Judicial Analysis of Policy Wording to Consider the Market Role of D&O Liability Insurance

Besides determining whether a D&O policy was meant to be a liability policy or an indemnification policy, courts must also determine whether the requirements for coverage127 are met by CERCLA potential liability notice. Five requirements must be met to find D&O liability coverage. First, there must be loss and a legal obligation to pay. Second, there must be no indemnification by the corporation. Third, there must be a wrongful act actually committed or attempted, or allegedly committed or attempted before or during the policy period. Fourth, the claim must be made against the insured during the policy period (or some extended period).128 And finally, the loss must not be the result of a claim arising from circumstances excluded under the insurance policy’s exclusions.129

proper insurance market operation, for independent individual risks). “Socio-legal risks,” such as the risk of the courts relaxing legal standards, are highly correlated and not independent. See id. at 1544; see also Patricia M. Danzon, Tort Reform and the Role of Government in Private Insurance Markets, 13 J. LEGAL STUD. 517, 536 (1984) (noting that "socio-legal" risks may destroy the insurer’s ability to predict loss distribution with accuracy). Therefore, present judicial interpretations of D&O insurance policies favoring liability coverage for insureds prevent insurers from realizing the comparative advantages of aggregating a class of independent risks.

126 Cf. Priest, supra note 19, at 1572 n.198 (stating that “[t]he complete withdrawal of insurers from day-care coverage is strong evidence that judicial efforts to force coverage of uninsurable risks . . . are short-sighted, reducing effective insurance levels”).

127 For, even if liability coverage is found using heuristic reasoning that addresses the purposes and drafting of the entire policy, liability coverage does not exist for all potential liabilities.

128 For example, under the Chubb Policy:

The [insurer] shall pay on behalf of each of the Insured Persons all Loss for which the Insured Person is not indemnified by the Insured Organization and which the Insured Person becomes legally obligated to pay on account of any claim first made against him, individually or otherwise, during the Policy Period or, if exercised, during the Extended Reporting Period for a Wrongful Act committed, attempted, or allegedly committed or attempted, by the Insured Person(s) before or during the Policy Period.

Chubb Policy, supra note 111, cl. 1.1 (emphasis omitted); see also National Union Policy, supra note 111, Form 47353, cl. 1 (requiring essentially the same events to occur).

129 Common policy exclusions include regulatory exclusions, insurer versus insured exclusions, pollution exclusions, securities exclusions, and property damage
In determining whether an environmental liability requires coverage by a D&O liability policy, the first question is: has there been a loss under the terms of the policy. "Loss" is a term of art that is defined in the policy. Typically, it is defined as "damages, judgments, settlements and Defense Costs . . . incurred in the defense of actions, suits or proceedings and appeals therefrom; . . . [l]oss shall not include civil or criminal fines or penalties imposed by law." Losses deliberately caused by the insured are outside the concept of risk, implying that there must be some quality of uncertainty to the loss-generating event. The second requirement, that there be no indemnification by the corporation, prevents double recovery by the insured D&Os and double payment by the insurer. Since all D&O liability policies contain corporate indemnification policies, double recovery would occur if the insurer reimbursed the corporation and provided liability coverage to the individual. The third requirement, that there be a "wrongful act" by the insured before or during the policy period, prevents an insured from claiming a loss for an act or alleged act that is done after the insured is no longer covered by the agreement. Such a requirement limits the duration of the coverage.

The most important aspect of liability insurance is the extent of the losses that it covers. Liability insurance provides that in addition to liability for damages (for example, response costs), defense costs will be treated by courts as losses. Indeed, in some policies the coverage of defense costs under the terms and

or bodily injury exclusions. See National Union Policy, supra note 111, Form 47353, cl. 4; see also infra notes 147-70 and accompanying text (discussing the pollution exclusion in detail).


See National Union Policy, supra note 111, Form 47353, cl. 2(b) (stating that "Defense Costs means reasonable and necessary fees, costs and expenses consented to by the Insurer . . . resulting solely from . . . any claim against the Insureds" (emphasis added)).

See KNEPPER & BAILEY, supra note 39, § 21.07 (stating that losses are "distinctly different from the underlying 'Wrongful Acts' for which directors or officers may be liable"). Furthermore, it has been held that the insurer of a D&O liability policy is only liable for losses, and not for the underlying "wrongful acts" for which D&Os may be liable. See Gilliam, 735 F. Supp. at 352.

See Okada v. MGIC Indem. Corp., 823 F.2d 276, 280 (9th Cir. 1986) (concluding that language stating that loss included "defense of legal actions, claims or proceedings and appeals therefrom," which the insured "directors are legally obligated to pay" supported a duty by the insurer to pay legal expenses as they were incurred); see also Pacific Indem. Co. v. Linn, 766 F.2d 754, 760 (3d Cir. 1985) (stating that "an insurance company is obligated to defend an insured whenever the complaint filed by the injured party may potentially come within the policy's coverage").
conditions of the policy is presumed. Immediate defense costs include discovery costs in determining the identities of other PRPs who should be joined, environmental consultation to determine the most cost-effective cleanup plan for a site, and legal costs associated with negotiations with the EPA. There is a possibility that such costs may not be covered by statutory or contractual indemnity. Liability coverage of defense costs relieves D&Os of a substantial financial burden not provided by indemnity insurance. Once an insurer's obligation to provide financial coverage is triggered by a claim made during the policy period and the loss is potentially covered by the policy agreement, the insurer has the obligation of paying defense costs as they are incurred.

a. Inability of D&O Liability Insurance to Work as an Effective Market Tool Arising from Judicial Failure to Regard EPA Notification of Insureds as an Event Triggering Coverage

The fourth requirement, that a claim must be made against the insured during the policy period, is especially important in CERCLA claims. Whether a PRP notice of liability is a claim that triggers a loss is important because D&O liability insurance is "claims-made." Claims-made policies require that a claim be made during the policy period. To determine the effect of a PRP notice one must

134 See National Union Policy, supra note 111, Form 47353, cl. 1, Coverage A & cl. 9 (requiring the insurer to advance to each and every D&O the defense costs of claims prior to their final disposition and that such advance payments be repaid by the insureds, "severally according to their respective interests," in the event they are not entitled to the coverage under the terms and conditions of the policy).

135 See supra notes 95-102 and accompanying text.

136 See Chubb Policy, supra note 111, cls. 6.1-6.3 (requiring that consent to advancement of defense costs not be "unreasonably" withheld); see also Gon v. First State Ins. Co., 871 F.2d 863, 868 (9th Cir. 1989) (stating that although D&O liability policies generally require no duty to defend, the absence of a duty to defend is not crucial because D&O liability policies impose upon insurers a duty to pay defense expenses as incurred); Little v. MGIC Indem. Corp., 836 F.2d 789, 794-95 (3d Cir. 1987) (finding that unless a duty to pay defense costs as they are incurred is explicitly negated by a D&O liability policy, the policy must be construed against the insurer as providing such a duty).

137 Under a claims-made insurance policy:

[T]he insurer agrees to assume liability for acts or omissions of the type covered by the policy regardless of when they occurred, if (1) the claim arising out of the act or omission was made during the policy period, or (2) notice was given to the insurer within the policy period as to an occurrence which may subsequently give rise to a claim. . . . This is compared to an occurrence policy, which covers acts or omissions occurring during the policy period regardless of when the subsequent claim is filed.

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know that CERCLA requires mandatory responses for which the EPA, or any other responding party, recover its response costs. The mandatory responses include short-term or "removal" costs for a spill or sudden leak and long-term or "remedial" costs in situations where the site requires a full-blown cleanup. A response is always initiated by notification advising PRPs of their legal obligation to pay for a claim (such as conducting an Remedial Investigation and Feasibility Study) or for a wrongful act (some

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responsible relationship to the hazardous waste site under CERCLA) and, thus, should meet the definition of a loss.\footnote{See New York v. Blank, 745 F. Supp. 841, 852 (N.D.N.Y. 1990) (holding that following EPA notice to PRP, "regardless of the date upon which the complaint was actually filed, [the insurer] has an obligation to reimburse [the insured] for all defense costs which he incurred for services rendered which are useful in defending against the first-party complaint").} This assertion finds support in Fireman's Fund Insurance Cos. v. Ex-Cell-O Corporation\footnote{Id. at 75.} where the court denied that "a traditional lawsuit for money damages" was needed to trigger coverage.\footnote{Id. But see Upjohn Co. v. Actna Casualty & Sur. Co., No. K88-124 GA4, 1990 U.S. Dist. LEXIS 6724, at *24 (W.D. Mich. June 4, 1990) (concluding that the Fireman's Fund decision is incorrect).} The court held that a "suit includes any effort to impose on the policyholders a liability ultimately enforceable by a court."\footnote{See, e.g., John Hancock Healthplan, Inc. v. Lexington Ins. Co., No. 88-2308, 1989 U.S. Dist. LEXIS 11019, at *12-13 (E.D. Pa. Sept. 11, 1989) (holding that a threat to join D&Os in an action against their corporation may be a claim).} PRP notification letters, especially those that threaten to join D&Os personally in an action, entail a potential liability for the cost of an EPA approved study.\footnote{See generally Carter Day Indus., Inc. v. EPA (In re Combustion Equip. Assoc.), 73 B.R. 85, 87 (Bankr. S.D.N.Y. 1987) (finding that a PRP letter merely advises an insured of a potential liability), aff'd, 838 F.2d 35 (2d Cir. 1988). Since most CGL policies require an actual suit to trigger coverage, while D&O policies may require only a claim against an insured to trigger coverage, the standard for the triggering of coverage may not be the same under both types of policies. There are varied views on whether agency notice constitutes a "claim" or a "suit." Compare Mt. Hawley Ins. Co. v. FSLIC, 695 F. Supp. 469, 479-80 (C.D. Cal. 1987) (finding that letters from an administrative body imposing restrictions and threatening enforcement action constituted a claim) and Fireman's Fund, 662 F. Supp. at 75 (stating that "coverage does not hinge on the form of action taken or the nature of relief sought, but on an actual or threatened use of legal process to coerce payment or conduct by a policyholder" (emphasis added)) with California Union Ins. Co. v. American Diversified Sav. Bank, 914 F.2d 1271, 1277 (9th Cir. 1990) (disapproving of the Mt. Hawley decision and interpreting the term "claim" not to include an agency's request that the insured comply with regulations where the agency does not threaten liability), cert. denied, 111 S. Ct. 966 (1991) and Bensalem Township v. Western World Ins. Co., 609 F. Supp. 1343, 1348 (E.D. Pa. 1985) (finding "notice [that it is a third party's] intention to hold the insureds responsible for a Wrongful Act" is an event commonly antecedent to and different in kind from a 'claim'" (quoting the insurance policy at issue)).} Insureds can certainly show that PRP notification letters consistently result in some legal obligation of the notified PRP and
such notice should, therefore, be regarded as a coverage-triggering event.\textsuperscript{145}

It is in the best interest of the PRP to negotiate a cost-effective consent decree with the EPA for two reasons: first, to trigger a claim under the claims-made policy (assuring the policy coverage is not lost before a claim is finally made), and second, to minimize the PRP's response costs.\textsuperscript{146} Assuming the insurer ultimately will be liable for a portion of the final cost, an early consent decree would be preferred by the insurer for the same reasons. However, if the insurer can prevent the claim from being made during the duration of the policy—thus avoiding coverage under a claims-made policy altogether—the insurer will prefer to delay.

Considering the large costs potentially attributable to a single loss, possibly the most significant criterion of CERCLA liability coverage under a D&O liability policy is the requirement that the loss not be incurred as a result of circumstances covered under a policy's exclusions. Technically, there are a number of possibilities in a standard policy for a carrier to use to deny coverage for CERCLA liability. The foremost of these is the pollution exclusion; for a truly effective pollution exclusion—providing it does not contravene public policy—will exclude claims arising from civil, criminal, or private actions connected with seepage, pollution, or contamination. Such an exclusion will deny a director or officer the liability insurance protection of the D&O liability policy by preventing advancement of interim defense costs and consultation costs as well as the ultimate remedial damages.

\textsuperscript{145} State and federal courts stand divided on this issue. \textit{See} \textit{Ryan v. Royal Ins. Co.}, 916 F.2d 731, 738 (1st Cir. 1990) (comparing various courts' decisions on whether a PRP letter institutes a "suit"). For instance, a recent analysis of New York law regarding the unsettled issue of whether liability insurance coverage is triggered by a PRP letter found an "important common denominator: . . . the proposition that, to find agency conduct to trigger the duty to defend under New York law, there must be some cognizable degree of coerciveness or adversariness in the administrative body's actions." \textit{Id.} at 737-38.

\textsuperscript{146} \textit{See generally} Thomas M. Hamilton & Eric L. Routman, \textit{Cleaning Up America: Superfund and Its Impact on the Insurance Industry}, \textit{41 CPCU J.} 172, 175 (1988) (stating that although CERCLA's National Contingency Plan requires that cost-effectiveness be considered by the EPA in conducting a cleanup, statutory emphasis on permanent solutions has overshadowed cost-effectiveness as a consideration).
b. Judicial Avoidance of Whether a D&O Liability Policy is a True Liability Policy Through Circumvention of the Pollution Exclusion

In the mid 1980s, insurers started adding significant exclusions to their policies for claims arising from contests for corporate control. During this same period, the effects of the 1980 Superfund legislation were also beginning to be realized by insurers as a number of financially responsible parties sought coverage under Comprehensive General Liability (CGL) policies. The legal environment that developed out of CERCLA recovery actions—a combination of unforeseeable risk and doctrinal instability—resulted in true uncertainty for insurers. For example, CGL policies that were purposely limited in their coverage to “sudden and accidental” pollution incidents to avoid the costs of intentional pollution or long-term releases resulted in courts dividing on how to interpret those terms.

147 See BLOCK ET AL., supra note 27, at 603-06.
148 See KATZMAN, supra note 104, at 10 (stating that chemicals which themselves may be relatively harmless can combine with others in the environment and, through a chain of chemical reactions, become a hazardous chemical); D’Arcy & Herricks, supra note 18, at 74 (arguing that heterogeneous exposure units, indefinite damage losses, unknown time when loss occurred, inexact determinability of contributors to the loss, and moral hazard all combine to make hazardous waste actions a poor subject of risk analysis).
149 See KATZMAN, supra note 104, at 78-79 (discussing the uncertainty of insurers resulting from differences in common law liabilities among states and between statute and common law, the effect of joint and several liability, and judicial willingness to ignore pollution liability exclusions).
150 See DEPARTMENT OF THE TREASURY, HAZARDOUS SUBSTANCE LIABILITY INSURANCE at v (1982) (finding that “[t]he major insurability problem under CERCLA has to do with the particular combination of liability and financial responsibility provisions which tend to render the liability exposure of the insurer too uncertain for traditional underwriting practices”). See generally John A. Siliciano, Corporate Behavior and the Social Efficiency of Tort Law, 85 MICH. L. REV. 1820, 1832-33 (1987) (arguing that unforeseen risk and changes in rules of liability are too unpredictable to set an insurance premium based on projected future costs).
152 See id. at 15-16 (listing cases favoring policyholders and discussing recent cases holding in favor of insurers); Eugene R. Anderson & Avraham C. Moskowitz, How Much Does the CGL Pollution Exclusion Really Exclude?, RISK MGMT., Apr. 1984, at 28, 36 (concluding the pollution exclusion only excludes deliberate pollutions intended to cause injuries); Bruce H. Winkelman, Insurance Coverage Issues in Environmental Pollution and Toxic Tort Litigation, 41 CPCU J. 93, 98-100 (1988) (noting some recent conflicting judicial interpretations).
The controversy of CGL policy pollution exclusions revolved around either finding the exclusion ambiguous or interpreting the exclusion quite narrowly.\textsuperscript{153} The reaction to judicial policy of creating judge-made insurance contracts is evident in typical D&O liability policy pollution exclusions.\textsuperscript{154} Consider, for example, the following excerpt from one D&O policy:

[This policy excludes payment for loss connected with claims] for seepage, pollution or contamination and based upon or attributable to violation or alleged violation of any federal, state, municipal or other governmental statute, regulation or ordinance prohibiting or providing for the control or regulation of emissions or effluents of any kind into the atmosphere or any body of land, water, waterway or watercourse or arising from any action or proceeding brought for enforcement purposes by any public official, agency, commission, board or pollution control administration pursuant to any such statutes, regulations, or ordinances or arising from any claims alleging seepage, pollution or contamination based upon common law nuisance or trespass.\textsuperscript{155}

The exclusion, however, is narrow and potentially ambiguous, and can be read in two ways. The first and most restrictive interpretation reads the exclusion as precluding coverage in three different situations: (1) for liability for contamination or pollution release \textit{and} based upon a violation of an environmental statute, regulation or ordinance; or (2) for liability arising from any enforcement action or proceeding brought by a public entity based on environmental law; or (3) for liability arising from claims alleging contamination or pollution release based upon common law trespass or nuisance. The combined effect of this interpretation, finding

\textsuperscript{153} See Hamilton & Routman, \textit{supra} note 146, at 183.

\textsuperscript{154} See DAN L. GOLDWASSER, DIRECTORS' AND OFFICERS' LIABILITY INSURANCE AND SELF-INSURANCE 52 (1986) (stating that most D&O policies have exclusions applicable to seepage, pollution, and contamination claims).

\textsuperscript{155} Chubb Policy, \textit{supra} note 111, cl. 3.1(d). Some policies may extend this exclusion more broadly. See, e.g., National Union Policy, \textit{supra} note 111, Form 47353, cl. 4(j) (excluding loss based on claims "alleging, arising out of, based upon, attributable to, or in any way involving, directly or indirectly: (1) the actual, alleged or threatened discharge, dispersal, release or escape of pollutants, or (2) any direction or request to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants"). This National Union Policy exclusion is much broader than the one contained in National Union's earlier policy. The earlier policy excluded only claims "arising from charges of seepage, pollution, or contamination." National Union Fire Insurance Co. of Pittsburgh, Pa., Directors and Officers Insurance and Corporation Reimbursement Policy, National Union Form 8749, cl. 4(m) & Form 8750, cl. 4(m) (1985) (on file with author).
three exclusions in one, but with only the first requiring a finding of actual seepage, pollution, or contamination, is to preclude coverage in the last two cases without an actual showing of contamination or release. The result of such an interpretation would be that insureds would be denied defense coverage associated with the receipt of an EPA notification of intent to join individual officers or directors as PRPs.

A second interpretation would combine the first criterion ("for seepage, pollution or contamination") with each of the three excluded events. It would provide an exclusion: (1) for liability for contamination or pollution release and based upon a violation of a statute, regulation, or ordinance; or (2) for liability for contamination or pollution release and arising from an enforcement action by a public entity; or (3) for liability for contamination or pollution release and arising from any claims alleging the same under common law trespass or nuisance theories. The effect of this interpretation would be to preclude D&O liability coverage only in those cases where it is proven that seepage, pollution, or contamination actually occurred as a result of the insured’s actions. The result of such an interpretation would provide coverage of defense costs for an insured receiving a PRP notice.

Since insurance contracts are prepared by the insurer’s experts, who are learned in the law of insurance, it is not unfair that the insurer “bear the burden of any resulting confusion.” Therefore ambiguities of insurance policies are to be “liberally construed in favor of [the insured] and strictly construed, whenever possible, against the insurer in order to afford the protection which the insured was endeavoring to secure when he applied for the insurance.” Accordingly, the second interpretation of a typical D&O liability policy pollution exclusion would be the most reasonable.

Thus, under the quoted policy, the advancement of defense costs, though permissive only, shall not be withheld unreasonably. The insurer must, therefore, provide defense costs to the PRP insured until it is shown that the insured's actions were the actual proximate cause of the seepage, pollution, or

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158 See supra note 136.
contamination and that the CERCLA action is not based simply on strict, joint, and several liability claims of a public or private entity against one of many PRPs. In contrast, under another D&O policy, even though the pollution exclusion is significantly more inclusive than the exclusion just analyzed, the Coverage Clause and a related Defense Costs Clause effectively provide defense costs until it is shown that the loss is excluded by the policy. Such a policy would provide effectively the same protection in defending against personal CERCLA liability.

Pollution exclusions may also be found by courts to be contrary to public policy or to the primary purpose of D&O liability insurance. Under close comparison, the provisions of the D&O liability insurance policies' pollution exclusion clauses appear analogous to a regulatory agency exclusion. Courts are in disagreement as to whether such regulatory agency exclusions violate public policy or are contrary to the primary purpose of the insurance policy. Regulatory agency exclusions are typically denied effect by the courts if they are aimed at actions involving the

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159 See supra note 155 (discussing a National Union Policy).
160 See National Union Policy, supra note 111, Form 47353, cl. 1, Coverage A (stating "[t]he Insurer shall, in accordance with and subject to Clause 9, advance to each and every Director and Officer the Defense Costs of . . . claims prior to their final disposition.); id. cl. 9 (stating that under Coverage A, "the insurer shall advance Defense Costs prior to the final disposition of the claim" unless corporate charter or bylaws, or common or statutory law require or permit advancement of defense costs).

It is understood and agreed that the Insurer shall not be liable to make any payment for Loss in connection with any claim made against the Directors or Officers based upon or attributable to any action or proceeding brought by or on behalf of the Federal Deposit Insurance Corporation, the Federal Savings & Loan Insurance Corporation, any other depository insurance organization, the Comptroller of the Currency, the Federal Home Loan Bank Board, or any other national or state regulatory agency . . . including any type of legal action which such agencies have the legal right to bring.

Id. at 602.

Federal Deposit Insurance Corporation, the Federal Savings & Loan Insurance Corporation, or the Federal Home Loan Bank Board, as contrary to the federal policy behind those agencies. In *FSLIC v. Oldenburg*, the district court found that regulatory agency exclusions do not violate public policy as a matter of law, but are unenforceable where they contravene a federal agency’s ability to perform its statutory duty. The regulatory agency aspects of a pollution exclusion would exclude claims arising from an enforcement action brought by the EPA, a federal regulatory agency. Certainly, denial of coverage for an EPA claim, where the policy would otherwise cover liability, can be interpreted to contravene the EPA’s statutory duty to clean up hazardous waste sites. This would be contrary to the public policy of CERCLA as much as a comparable regulatory agency exclusion is in contravention of FIRREA.

Congress has announced its intention that the courts determine whether contractual terms agreed upon by insureds and insurers (specifically, exclusion provisions) contravene the public policy behind federal statutes. The government’s statutory duty as a conservator or receiver is arguably just as great in preserving the environment as in preserving the banking industry. Therefore, courts may find that pollution exclusions are contrary to the public policy behind the EPA’s protection of the environment.

163 *See e.g., Branning,* 721 F. Supp. at 1184 (denying effect to regulatory agency exclusion as it “substantially hinders FSLIC’s exercise of its federal powers and therefore is contrary to federal policy”).


165 *See id.* at 723-24; *see also American Casualty Co. v. FDIC,* No. 86-4018, 1990 U.S. Dist. LEXIS 6065, at *58-59 (N.D. Iowa Feb. 26, 1990) (finding the regulatory agency exclusion was unconscionable, violating both the insured’s “reasonable expectations of insurance coverage” and the insurer’s “implied warranty of fitness”), *aff’d in part and rev’d in part,* Nos. 90-2402NI, 90-2445NI, 1991 U.S. App. LEXIS 21963 (8th Cir. Sept. 18, 1991).


167 *See 135 CONG. REC. S10,198* (daily ed. Aug. 4, 1989) (statement of Sen. Garn) (noting that congressional conferees were neutral regarding regulatory agency exclusions and that they wanted case law relating to the validity of regulatory exclusion clauses to develop uninfluenced).

Where the parties' intent to limit the coverage of the policy is manifest, and yet is disregarded by the courts a real possibility exists that insurers, unable to limit their exposure to CERCLA liability, will have no choice but to eliminate their increased exposure. At that point, the only market mechanism to protect D&Os will no longer exist. Failure of both public and private responses to individual CERCLA liability in those states where liability is not limited by statute will force D&Os to find some other way to protect themselves from unacceptable personal risk. As a result of the restrictions on or elimination of commercial insurers' coverage of such liabilities, a responsible corporation would react to potential liability by reserving funds in a liability trust, or by self-insuring through risk pools backed by reinsurers or by a captive insurer. Because the risk of hazardous waste is generally unforeseen, potential generators cannot be expected simply to "get out of the market" of pollution liability.\(^1\)\(^6\)\(^9\) Therefore, the only alternative is for D&Os to "get out of the market" of personal liability and move their operations to a state providing more substantial statutory protection.

CONCLUSION

In many ways, the marketplace for environmental liabilities, plagued by the substantial uncertainty of hazardous waste cleanup liabilities, is much like the marketplace affected by products liability uncertainties.\(^1\)\(^7\)\(^0\) As in the products liability market, corporations suffer from imperfect information regarding risks, instability of tort law doctrines, and unpredictable shifts in popular attitudes toward acceptable risks.\(^1\)\(^7\)\(^1\) Unlike products liability markets, however, those who place a religious faith in insurance cannot gain more protection by getting more religion.\(^1\)\(^7\)\(^2\) History has shown that liability insurers will not respond to the uncertainties of environmental law by increasing premium charges in the face of uncertain-

\(^{169}\) In other areas of potential liability, it is possible for businesses simply to "get out of the market." See Siliciano, supra note 150, at 1851 n.108 (discussing withdrawal of drug and IUD manufacturers from the market when product liability became too great).

\(^{170}\) See id. at 1830-33, 1850-53 (discussing the "turbulent market" of products liability).

\(^{171}\) See id. at 1831-32.

\(^{172}\) See Patricia M. Danzon, Comments on Landes and Posner: A Positive Economic Analysis of Products Liability, 14 J. LEGAL STUD. 569, 573 (1985) (noting that producers will overinsure when faced with legal instability).
ties. Instead, they may attempt to withdraw from the marketplace of pollution liability coverage altogether.\textsuperscript{173}

One commentator has suggested that because industry "is in a better position to calculate its own risks than the insurers, industry-owned mutual insurance pools might have a comparative advantage over traditional insurers."\textsuperscript{174} Such pools have been successfully developed by the members of the nuclear industry and the oil industry.\textsuperscript{175} Ultimately, regulatory policy for employing insurance as a "market-oriented tool" for controlling environmental damages\textsuperscript{176} may be a federal or state government established insurance program.\textsuperscript{177} Certainly, D&Os, who are already subject to strict regulations under federal securities laws, would be prime candidates for a federal insurance pooling arrangement. Such an arrangement might be similar to the existing arrangement under Price-Anderson for nuclear licensees.\textsuperscript{178} Federal limited liability statutes would

\textsuperscript{173} See KATZMAN, supra note 104, at 83-85 (noting the dramatic withdrawal of insurers from the pollution liability market in 1984, following decisions going against insurers); D'Arcy & Herricks, supra note 18, at 77 (noting that the market was all but eliminated in 1984, and that by 1988, coverage was expensive and difficult to obtain).

\textsuperscript{174} Martin T. Katzman, Pollution Liability Insurance and Catastrophic Environmental Risk, J. Risk & Ins., Mar. 1988, at 75, 93.

\textsuperscript{175} These two industries use different methods to pool risks, both of which can be applied to the risk of hazardous waste release. The oil industry insures its members' refineries through an industry-owned and industry-monitored risk pool, known as Oil Insurance Limited. See Louise Kertesz, OIL Sets Example For Other Captives, BUS. INS., Apr. 30, 1990, at 136, 136.

In accordance with the Price-Anderson Act, 42 U.S.C. § 2210 (1988), a legislatively-initiated insurance program, the nuclear industry has formed two separate pools of members that are insured by independent insurance companies: the Nuclear Energy Liability Insurance Association and the Mutual Atomic Energy Liability Underwriters. See Francis X. Boylan, The Nuclear Risk: Conventional Insurance Exclusions, Private and Governmental Coverages, 42 CPCUJ. 220, 221 (1987). Virtually all of the significant property and casualty insurance companies throughout the world have participated in these pooling arrangements, as primary insurers and reinsurers. See id.

\textsuperscript{177} See Katzman, supra note 174, at 94.

\textsuperscript{176} For example, the 1975 amendments to the Price-Anderson Act, 42 U.S.C. § 2210 (1988), obligate each large power reactor licensee to pay a "deferred premium" of up to $5 million per nuclear incident, per licensee's reactor, for incurred losses sustained by any licensee that exceeds the government mandated financial protection requirement. See Boylan, supra note 175, at 229. Both the Nuclear Energy Liability Insurance Association and the Mutual Atomic Energy Liability Underwriters agreed to absorb up to $30 million in credit risks for licensees who fail to pay. See id. See generally States Acting on Liability Insurance, 16 Env't Rep. (BNA) 2140 (March 28, 1986) (noting that some states may attempt to provide environmental regulatory insurance coverage at the state level).

\textsuperscript{178} See Boylan, supra note 175, at 220-21.
then apply along the lines of those limited liability statutes already existing in some states.\textsuperscript{179} On the other hand, if regulated at the state level, state pollution liability insurance for D&Os would accord with the rationale behind existing state law liability limits for corporate managers,\textsuperscript{180} and would provide preemptive protection of individuals from CERCLA liability for funding of cleanups.\textsuperscript{181}

The problem of unforeseen environmental effects of managerial decisions is not one that will be easily overcome. Indemnity provides little comfort to the executive faced with bearing the burden of personally litigating a CERCLA action which may extend for years with continuing joinder of PRPs and negotiations with the EPA. Statutory limits on potential liability are not available in all states, and may be preempted by the public policy behind CERCLA in states where such statutes do exist. For the present, where CERCLA is found to be predominant, there is only risk—risk that no sector of the insurance marketplace willingly seeks to reduce through insurance coverage.

This is a far cry from the situation in the nineteenth century when steam boilers were being developed for industrial purposes.\textsuperscript{182} Where developing technology offered both the promise of economic return and the substantial risk of explosion, insurers assumed a leadership role by creating an incentive to have safety features in the testing of boiler models, by monitoring the insureds' premises, and by reducing rates for boilers having a lower probability of loss.\textsuperscript{183} In that situation, however, the only risk-determinant was the physical danger of boiler explosion. In the CERCLA situation, there are not only the physical dangers of release and

\textsuperscript{179} See supra notes 81-83 and accompanying text.

\textsuperscript{180} Some considerations behind statutory liability limits also apply to public insurance protection: fairness, where the potential liability is excessive compared to the defendant's culpability; economic logic, where strict liability or liability for negligence might lead risk-averse management to adopt more conservative policies than are economically efficient; and insurance costs, where government agencies can monitor insureds and regulate premiums on grounds of equity and risk-creating behavior. See PRINCIPLES OF CORPORATE GOVERNANCE, supra note 67, § 7.17 cmt. c, at 227; Katzman, supra note 174, at 93.

\textsuperscript{181} The McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. §§ 1011-15 (1988), exempts the states' regulation of insurance from the reach of federal laws, such as CERCLA. See id. § 1012(b) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . . unless such Act specifically relates to the business of insurance . . . ").

\textsuperscript{182} See D'Arcy & Herricks, supra note 18, at 77.

\textsuperscript{183} See id.
contamination, but the moral hazard of risk-creating behavior, the risk of administrative agencies changing the standards of "contamination," and the uncertainty of judicial construction of liability statutes and insurance policies in light of the public policy expressed by such statutes.

In the midst of this environment of uncertainty, individual risk further exaggerates these effects. Corporate managers must continue to operate their corporations as best as they can—charged with fiduciary duties toward the shareholders on the one hand, but vulnerable to individual liability on the other hand. No legal standard of protection exists for those D&Os who by act or by chance find themselves personally associated with a Superfund site. The concept of fiduciary duty of D&Os to shareholders can be broadened to apply to decisions affecting the environment as well. Insurance would then be sought only in those situations where the fiduciary duty of corporate managers to the government/environment had been breached.

Liability insurance has potential to act as an alternative to government regulation by allowing insurers to force safer industrial practices. As long as insurance is available, it will continue to be the salve of choice for courts to apply where there is individual liability for hazardous waste cleanup. A tremendous body of law has developed in the judicial interpretation of CGL policies, covering the liabilities of the corporation as a whole. In the situation where the fiduciary duty to the corporation nor the government has not been breached, individual D&Os may be covered by the corporation’s CGL policy as "insured(s)."

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184 The high remedial costs of cleaning up industrial waste sites in the United States constitute only a small fraction of industrial pollution prevention costs. See H. Smets, Compensation for Exceptional Environmental Damage Caused by Industrial Activities, in INSURING AND MANAGING HAZARDOUS RISKS, supra note 8, at 105. The risk of more stringent operating controls, therefore, arguably influences the decision-maker more than possible compensation of third parties. See id. at 106.

185 Ironically, this is true even though Congress has expressed a public policy to encourage insurance and indemnification. See CERCLA, § 107(e)(1), 42 U.S.C. § 9607(e)(1) (1988) (providing that "[n]othing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section").

186 See Baram, supra note 8, at 418.

187 A large volume of common law regarding the interpretation of CGL policies has been developed (favorable to corporations in all jurisdictions) which would reduce the risk associated with environmental decisions. See supra notes 144-45 and accompanying text (noting cases discussing whether a PRP letter triggers CGL coverage); see also supra note 152 (providing source listing numerous cases regarding
corporation's D&Os in the definition of the "insured(s)" in the CGL policy, an alternative to uncertain judicial construction of D&O liability policies and an additional potential source of coverage for personal liabilities will be available. In an insurance marketplace where fault-based liability relies on the outcome of causation findings, insurers will assume a leadership role by monitoring the activities and decisions of insureds (both corporations and individuals) to determine whether CGL policy coverage or D&O policy coverage applies. Moreover, insureds would have a real incentive to act with good faith and to use their best judgment in decisions involving hazardous waste in order to receive more certain coverage.

In the meantime, D&O liability insurers must take an active role in the litigation decisions of their insureds and in their negotiations with the EPA to ensure that a D&O liability policy is not being used to supplement a corporation's CGL policy. Insurers are likely to remain the primary source for environmental cleanup costs, no matter how explicit they attempt to make their desire to be relieved of the pollution liability burden. As one Justice Department official stated in justifying appropriation of insurers' funds to pay for Superfund cleanup costs:

"We were facing a $100 million shortfall in coverage of costs of cleaning up dioxin contamination . . . and had exhausted other avenues of recovery . . . We don't want to get in the middle of what is a conflict between one part of corporate America [(insurers)] and another [(insureds)], but if appropriate cases come up, and we have no place left to look for cleanup funding, we will do so again." ¹⁸⁸
