RECOVERY BY UTILITIES OF EXPENDITURES ON MANUFACTURED GAS PLANT CLAIMS: RECENT DEVELOPMENTS REGARDING INSURANCE COVERAGE AND RATE RELIEF*

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Many utilities are facing substantial environmental liabilities under federal and state laws requiring the investigation and remediation of soil and groundwater contamination at sites where gas was manufactured from fossil fuels before the era of natural gas. The estimated cost of investigating and remediating a typical site of a former manufactured gas plant ("MGP") ranges between $1.4 million to $9 million, and there are more than 1000 MGP sites throughout the United States. In light of the substantial magnitude of these costs, an increasing number of utilities are pursuing various means for recovering the costs of defending and resolving environmental claims at former MGP sites ("MGP costs").

1 The authors represent utilities and other policyholders in environmental insurance coverage litigation and rate proceedings. The views expressed in this article are the views of the authors and not necessarily those of the clients of Covington & Burling. The authors wish to thank Ronald G. Dove, Jr., Matthew S. Yeo and Jonathan B. Mirsky for their help with this article. Portions of this article originally appeared in Goodman, "Insurance Coverage for Environmental Claims: Cost Recovery by Utilities and Pipeline Companies for Expenditures on Environmental Claims," 5 Nat. Gas Law. J. 91 (1991).


One possible method of recovering MGP costs is through insurance coverage. Most utilities purchased for decades the broadest form of liability insurance sold in the marketplace, Comprehensive General Liability ("CGL") policies or excess policies that provide comparable coverage. The terms of the CGL policy and its drafting history provide compelling support for the argument that the policy generally covers environmental liabilities. Accordingly, a number of utilities are now seeking — and some have already secured — insurance coverage for their MGP costs. A review of the judicial decisions in MGP coverage cases reveals that the courts have generally been ruling in favor of the utilities seeking coverage for MGP costs.

Another possible means for recovering MGP costs is through the utility's rates. A majority of the public utility commissions that have addressed this issue in contested cases have granted full recovery from ratepayers of costs prudently incurred in investigating and remediating MGP sites, net of any insurance or other third-party reimbursements (hereinafter "net MGP costs"). These commissions have done so by including projected net MGP costs in base rates, or, more commonly, by amortizing the net MGP costs over a specified period and allowing the recovery of those costs, with carrying charges, through a special "rider" or "tracker." A minority of commissions that have addressed this issue in contested cases have ruled that utility shareholders and ratepayers must share in net MGP costs through amortization without carrying costs, while several jurisdictions have approved settlements that embody some aspect of sharing of net MGP costs between shareholders and ratepayers. Only one commission has completely denied recovery of net MGP costs.

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These two means of recovering MGP costs — insurance coverage and utility rates — are interrelated, for public utility commissions in their rate decisions have expressly provided incentives to encourage utilities to pursue their insurers to recover MGP costs, such as by allowing utilities to recover through rates the costs of pursuing insurance coverage. Moreover, the aggressive pursuit of insurance coverage was cited by the New Jersey Board of Regulatory Commissioners as a factor supporting its favorable ruling in a contested rate proceeding involving the recovery of net MGP cleanup costs.\(^5\)

This article first examines the issue of insurance coverage for MGP costs. It outlines the policyholder theory of coverage and summarizes the key coverage defenses typically asserted by insurers in MGP coverage cases. The article then summarizes the significant judicial decisions in cases in which utilities have sought insurance coverage for MGP costs.

The article next examines the issue of rate recovery of net MGP costs. It outlines the arguments typically made for and against the full recovery of net MGP costs from ratepayers, and then summarizes the current status of reported decisions from public utility commissions on the issue of rate relief for net MGP costs, with particular emphasis on recent commission decisions.

\(^5\) Public Serv. Elec. & Gas Co., BRC Docket No. ER91111698J, slip op. at 18 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993) (citing the fact that Public Service Electric & Gas Co. has "been aggressively pursuing insurance recoveries" as one reason for rejecting the argument of the New Jersey Public Advocate that MGP costs should be shared equally between stockholders and ratepayers), reh'g denied, (Jan. 21, 1994).
I. INSURANCE COVERAGE FOR MGP COSTS

One possible means of recovering MGP costs is through insurance coverage under Comprehensive General Liability ("CGL") policies and excess policies providing comparable coverage. A review of the judicial decisions in MGP coverage cases reveals that the courts have generally been ruling in favor of the utilities seeking coverage for MGP costs.

A. Policyholder Theory of Coverage

The CGL policy is a standard-form contract that was drafted and periodically revised by insurance industry groups. The insurance industry, which began issuing CGL policies in the 1940s, marketed these policies as the broadest form of liability coverage generally available at the time.

The CGL policy, consistent with its marketing, provides for broad liability coverage. It states that, subject to stated policy limits and deductibles, the insurer will:

"pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of . . . property damage to which this insurance applies, caused by an occurrence . . . ."8

The term "property damage" refers broadly to any "physical injury to or destruction of tangible property which occurs during the policy period."9 Similarly, the term

6 In addition to CGL coverage, a utility may have coverage from MGP costs under its first-party property policies and environmental impairment liability policies. The focus here is principally on issues concerning CGL coverage.

7 The CGL policy was touted as "one of the most potent weapons for protection ever afforded a risk," Eglof, "The Outside," Best's Fire and Casualty News 19 (1941), and salesmen were urged to "[emphasize] 'peace of mind' coverage, i.e., [the] feeling of security and sense of protection that goes with Comprehensive Liability [coverage]." Id. at 56.

8 1 S. Miller & P. Lefebvre, Miller's Standard Insurance Policies Annotated, 411 (hereinafter cited as "Miller & Lefebvre"). The quoted language is drawn from the 1973 standard-form CGL policy.

9 Id. at 409.
"occurrence" is broadly defined to mean "an accident, including continuous or repeated exposure to conditions, which results in property damage neither expected or intended from the standpoint of the insured."¹⁰

The argument in support of coverage for MGP costs is straightforward: The CGL policy states that the insurer will pay "all sums" for damages because of "property damage" that occurs during the policy period. Policyholders assert that contamination at MGP sites is "property damage," and that such damage begins at the time contamination starts and continues until the contamination is remediated. Policyholders thus assert that coverage is triggered under each policy in effect during that period.

With regard to the scope of coverage, policyholders typically assert that, in light of the CGL language obligating the insurer to pay "all sums," each triggered policy is obligated to pay all of the costs associated with an MGP claim, subject only to applicable limits of liability and deductibles.¹¹

B. Insurer Defenses

In response to these arguments, most insurers have, as one court put it in another context, "run for cover rather than coverage."¹² There is now a standard litany of defenses asserted by insurers in MGP coverage cases. The key defenses include:

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¹⁰ *Id.*

¹¹ Policyholders also typically assert that, if several policies are triggered by the same claim, the policyholder is entitled to select which of the potentially applicable policies should provide coverage. They further assert that, although the insurer whose policy is selected may have a right to obtain contribution from other insurers whose policies are also triggered by the claim, under no circumstances can any portion of the loss be prorated back to the policyholder based on periods when no insurance was in effect or applicable insurance provides no coverage as a result of exclusions or exhaustion of limits.
1. No Damages

One of the stock defenses asserted by insurers is that government-mandated cleanup costs are not covered because such costs are akin to the costs of complying with an injunction and thus are not sums that the policyholder has become legally obligated to pay as "damages" within a strict legal definition of that term. In response, policyholders assert that the term "damages" should be read broadly to encompass not merely amounts awarded to other parties as legal damages, but also any funds expended to remedy damage that is otherwise covered by the policy, including funds expended for government-mandated cleanup actions.

2. Trigger of Coverage

Insurers also typically assert that even if environmental claims are found to be claims for "damages" within the meaning of their policies, they should not have to provide coverage because the property damage did not happen during the period of their policies. A recurring insurer argument is that all the contamination at MGP sites occurred before the inception of the policyholder's first policy.

By contrast, policyholders typically assert that property damage begins at the time contamination starts and continues until the contamination is remediated, and thus all policies in force during this period are triggered.

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3. **Scope of Coverage**

Another stock argument by insurers is that their policies should not have to pay all of the costs associated with a claim because their policies were only in effect during part of the time that the damage occurred.

They may argue, for example, that they should only have to pay a prorated share of the loss, based on the ratio of the length of time that their policies were in effect divided by the total length of time during which the damage has been occurring.

This is a very important issue in MGP coverage cases because many utilities are unable to locate policies acquired more than a few decades ago, whereas contamination at MGP sites may have occurred over a much longer time period, in some cases beginning well over a hundred years ago. If, for example, a loss were prorated over the period from 1885 to 1985, and the utility only has applicable insurance during one-third of that period, the utility would only be able to recover one-third of the loss from its insurers.

By contrast, policyholders typically assert that, because the CGL policy obligates the insurer to pay "all sums," a policyholder is entitled to recover the full amount of a claim under any triggered policy, subject only to the deductible and limits of the policy.

4. **Owned-Property Exclusion**

In environmental cases where a policyholder is seeking coverage for the costs of remedial work performed on its own property, the insurers typically assert that there is no CGL coverage because of the owned-property exclusion, pursuant to which coverage is excluded for "property damage to property damage to property owned or occupied by . . . the insured."13

In response, policyholders assert that remedial work performed on a policyholder's property is typically necessary to prevent third-property damage (such as the contamination of groundwater or adjacent property), and the owned-property exclusion does not purport to exclude coverage for third-party property damage, even if the remedy for such damage includes the remediation of the policyholder's property.

5. Pollution Exclusion

Another recurring insurer argument is that coverage for "gradual" pollution is excluded under policies containing the standard-form CGL pollution exclusion that was introduced in 1970. This exclusion states that coverage is excluded for various types of environmental contamination, but contains an exception that "[t]his exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental."

The insurers argue that the term "sudden" in the exception to the pollution exclusion is to be given a temporal meaning (i.e., quick or abrupt) and thus the exception does not reinstate coverage for "gradual", pollution. By contrast, policyholders argue that the term "sudden" should be construed, in accordance with one of its accepted dictionary definitions, to

14 This argument has no applicability to policies that do not contain pollution exclusions, and many utilities were able to purchase such policies in various years during the 1970s and 1980s.

15 The pollution exclusion provides in full:

"[T]his insurance does not apply to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental."

Miller & Lefebvre, at 411 (1973 Standard CGL policy).
mean "unexpected." Under this interpretation, the pollution exclusion would not exclude coverage for gradual pollution, unless it was "expected" or "intended."

6. Expected or Intended

The insurers, last line of defense in MGP coverage cases is typically the assertion that there is no covered "occurrence" because the utility "expected" or "intended" the property damage. The insurers attempt to prove this point by seeking to demonstrate that the gas industry had an early awareness that gas manufacturing could cause environmental problems. The insurers rely heavily on historical industry literature, particularly reports issued during the 1920s by the American Gas Associations' Subcommittee on Disposal of Waste from Gas Plants.16

The response of utilities is typically that their MGP operating and waste disposal practices were consistent with practices commonly followed by the gas industry (and other industries, for that matter) at the time in question and that those practices rarely resulted in nuisances for neighbors or any other types of environmental problems that were considered to be problems at the time that the plants were operating. The historical evidence about the gas industry demonstrates that the industry was aware that its operations could cause certain nuisances but it took steps to try to prevent nuisances and, for the most part, those steps were successful. There were, in fact, relatively few nuisance claims involving groundwater contamination for an industry that operated more than 1,000 gas plants at various times over a period of more than 100 years. Moreover, the reason why environmental regulators are now requiring that MGP sites be investigated and remediated could not have been reasonably

foreseen — much less have been expected or intended — at the time that the plants were in operation.  

C. Rulings Generally Favorable to Policyholders


This case was filed by Washington Natural Gas Co. ("WNG") in state court in Washington. WNG sought coverage for cleanup and defense costs at a Tacoma, Washington site where it owned and operated a manufactured gas plant from 1928 until 1956.

a. Jury Verdict

After a two week trial and after deliberating for only 45 minutes, a jury returned a verdict in favor of WNG. The jury found that property damage had occurred during each of the years of WNG's insurance policies from 1950 through 1985, thus triggering coverage under the policies for each of those years. The jury also found that WNG did not expect or intend for such damage to occur during those years, thus rejecting one of the insurer's key coverage defenses.  

b. Allocation

Following the trial, the court rejected an attempt by the insurers to reduce their obligation to WNG by allocating a portion of the cleanup costs to years prior to WNG's policies. In granting WNG's motion for partial summary judgment on the issue of allocation, the court

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17 In most jurisdictions, remediation requirements are premised on human health concerns that are of relatively recent origin. During the period of historical gas plant operations, leading health scientists would not have regarded contamination of soil or groundwater with gas plant materials as posing a human health risk (to the extent that wells became contaminated, people would not have drunk the water because it would have had a bad taste). The 1920 report of the AGA, which identified all of the problems that had ever allegedly been caused by the disposal of gas plant wastes in the United States or England on the basis of an industry survey, did not include injury to human health on its list of potential problems.
stated that WNG's "insurers must be held to their respective contract obligations to cover all
sums, incurred by [the] insured as damages for WNG's [environmental] liabilities.19 The court
noted that "[t]here is a wide range of imaginable answers to the allocation problem, yet [all of
them are] speculative."20 Since defendants could not "meet their burden of proving either a
uniform or an uneven allocation of remediation costs in fact, the terms of their contracts
mandate[d] full joint and several coverage up to their policy limits (allowing, of course, for
deductibles and the amount of underlying coverage where the policy [was] for excess
coverage)."21

c. Attorney Fees and Costs

Following the trial, the court also ordered the insurers to reimburse WNG for $4.6
million in attorney fees and costs. The court ruled that the liability of the insurers for these fees
and costs was joint and several, but limited the fees and costs that WNG could collect from
certain insurers whose policies had relatively low face amounts until WNG had reasonably
exhausted all other sources of payment from the remaining insurers."22

18 Mealey's Litigation Reports — Insurance (Nov. 2, 1993), at 3. The insurers appealed the
jury verdict, but the case was settled before any appellate decision on the merits of the case was
issued.
19 Memorandum Opinion on Plaintiff's Motion for Partial Summary Judgment & on
Defendants' Motion to Supplement Expert Testimony at 10-11, Washington Natural Gas Co. v.
Aetna Casualty & Surety Co. (hereinafter "WNG"), No. 91-2-13506-1 (King County Super. Ct.
Feb. 23, 1994).
20 Id. at 4.
21 Id. at 10 (emphasis in original).
22 WNG, No. 91-2-13506-1 (King County Super. Ct. Oct. 31, 1994), reprinted in Mealey's
Litigation Reports — Insurance (Dec. 20, 1994), at D-4 to D-5.
d. **Owned/Alienated Property Exclusion**

The insurers were denied summary judgment on virtually every issue they raised prior to trial. The court held that "[w]henever the costs of removal of pollutants from [an insured's] owned or alienated property exceed the reasonable fair market value of the property, they are prima facie a covered form of damage to interests other than the owner's, and are not excluded by the owned/alienated property exclusion." The court reasoned that "[o]nce the costs exceed that value, the interest being benefited by the cleanup costs is not the owner's ownership interest, but society's stated interest in the environment."

e. **Coverage for Cleanup Costs Traceable to Acts of Others**

The same court rejected the insurers' argument that their insurance policies excluded all liability imposed by law that was traceable to the acts of parties other than WNG or its predecessors in interest. The court held that "the fact that [another party] may have engaged in its own polluting activities, or may have aggravated or redistributed pollution initially attributable to the acts of WNG, will not provide a defense to or a limitation on coverage."

f. **"Expected or Intended" Standard**

After holding that there was a genuine issue of material fact as to whether WNG expected or intended to cause property damage, the court stated that it would "instruct the jury

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23 The one exception was American Home's motion for partial summary judgment under its 1985-86 absolute pollution exclusion. order on Motions for Partial Summary Judgment at 1, *WNG*, No. 91-2-13506-1 (King County Super. Ct. Sept. 23, 1993).

24 *Id.* at 4-5.

25 *Id.* at 3-4.

26 *Id.* at 5-6.

27 *Id.* at 6.
that its findings [should] be based on what it determine[d] WNG subjectively expected or intended" at the time of the acts in question, not by the standards of the 1990s.\textsuperscript{28} The jury ultimately found in favor of WNG on this issue.

\textbf{g. Stone & Webster Policies: "Event" and "Occurrence"}

The court held that the continuous process of soil and groundwater contamination at WNG's site — if proven —would trigger coverage under the Stone & Webster policies at issue in the case.\textsuperscript{29} The court noted that the word "event" in the "occurrence," definition of those policies was not limited "to a single unit of time."\textsuperscript{30} The court specifically concluded that the Stone & Webster "occurrence" language at issue imposed no limitation on the coverage that would have existed if the policies had contained standard occurrence language.\textsuperscript{31}

\textbf{h. Property Damage in Policy Period}

The court held that there was a genuine issue of material fact as to whether property damage occurred in each policy period and whether damages were the result of a continuous process.\textsuperscript{32} The jury eventually found in favor of WNG on these issues.

\textbf{i. Pollution Exclusion}

The court held that there was a genuine factual dispute as to whether "the discharge, dispersal, release or escape of pollutants" at the WNG site was "sudden and accidental" and thus not subject to the pollution exclusion.\textsuperscript{33} The court stated that it would

\begin{itemize}
\item \textsuperscript{28} Id. at 6-8.
\item \textsuperscript{29} Id. at 9-10.
\item \textsuperscript{30} Id. at 9.
\item \textsuperscript{31} Id.
\item \textsuperscript{32} Id. at 10-11.
\item \textsuperscript{33} Id. at 11.
\end{itemize}
"request the jury to make a determination as to when WNG developed a 'subjective expectation that contaminants would leak from its disposal ponds."" The court further stated that "WNG's expectation or intent [was] not to be judged by what is known or believed in the 1990's, but by what was known or believed at the time of the acts in question." 

j. Known Loss/Loss in Progress

The court rejected an insurer's argument that WNG should be denied coverage because it knew of the substantial probability of a loss prior to renewing its insurance coverage and failed to disclose that knowledge to the insurer. The court stated that "[i]n the absence of affirmative misrepresentations of material fact, there is no general rule in Washington State courts permitting one party to avoid a contract based on an alleged omission or failure of the other party to disclose future undetermined events, however admirable such a doctrine might otherwise be."

2. Public Service Electric & Gas Co. v. Certain Underwriters at Lloyd's of London

This case was filed by Public Service Electric and Gas Co. ("PSE&G") in the United States District Court for the District of New Jersey against AEGIS and certain London Market insurers. PSE&G sought coverage for MGP costs associated with 38 former manufactured gas plant sites and one third-party site at which MGP wastes had been disposed.

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34 Id.
35 Id.
36 Id. at 12-14.
37 Id. at 14.
In 1991, PSE&G dismissed its complaint against AEGIS pursuant to a settlement. PSE&G recently settled with the London Market insurers and dismissed the remainder of its complaint.

Prior to the recent settlement, the district court issued rulings on various cross-motions for summary judgment. These rulings were generally favorable to PSE&G.

a. "Expected or Intended" Issue

With regard to the "expected or intended" standard, the district court ruled that the insurers had the burden of proving that corporate officers of PSE&G expected or intended to cause environmental harm that is "qualitatively comparable" to the harm that triggered governmental cleanup demands.38

The court also ruled that the relevant time for making this determination was "the time that the acts causing the harm occurred and not the time that the policies were purchased." The district court denied the insurers' motion for summary judgment on the "expected or intended" issue. In denying the motion, the court noted: 39

Although there is evidence that contamination occurred during the relevant historical periods at each of the three sites, and that [PSE&G] was aware of the acts which contributed to, and in fact caused, that contamination, there is also evidence that those acts were consistent with accepted practices of the day, and therefore that [PSE&G] may have carried out those acts neither expecting-nor intending to pollute the environment in such a way as ultimately led to demands for remediation by the NJDEP.40

The court also emphasized that one of the insurers' own experts had admitted during his deposition that none of the operators of the sites had acted unreasonably and that the operators

39 Id. at 25-26.
had acted in accordance with practices that were common at the time and did not expect or intend harm to the environment.\textsuperscript{41}

The district court did not reach the question whether the conduct of prior operators of the sites could be imputed to PSE&G because of the court's conclusion that there was no evidence that the prior operators expected or intended harm.\textsuperscript{42}

\textbf{b. Owned-Property Exclusion}

The district court ruled that owned-property restrictions did not apply to formerly owned-property or to groundwater that had migrated off-site.\textsuperscript{43} The court ruled that "at this time" damage to groundwater that had not migrated off-site was subject to the owned-property exclusion under New Jersey law.\textsuperscript{44} This holding was based on a decision by a New Jersey state trial court in another case that is now on appeal, \textit{Reliance Insurance Co. v. Armstrong World Indus.}\textsuperscript{45} Armstrong has been criticized by another New Jersey trial court, and a decision by the New Jersey intermediate appellate court supports a contrary result.\textsuperscript{46}

\begin{flushright}
\textsuperscript{40} \textit{Id.} at 53-54.
\textsuperscript{41} \textit{Id.} at 66.
\textsuperscript{42} \textit{Id.} at 31-32.
\textsuperscript{43} \textit{Id.} at 62, 64-66.
\textsuperscript{44} \textit{Id.} at 60-62.
\end{flushright}
c. **Damages**

The district court held that environmental claims were claims for "property damage" within the meaning of the policies.\(^{47}\)

**d. Trigger of Coverage**

The district court ruled that the trigger of coverage under most of the policies at issue was property damage during the policy period and that such damage included the continued leaching and migration of contaminants after an initial leak or spill.\(^{48}\) The court ruled that in light of conflicting expert testimony, a trial was needed to resolve the question whether groundwater contamination occurred in each of the policy years, and whether the damage was "continuous" and "indivisible."\(^{49}\)

Under certain policies that defined an occurrence to be a "happening or series of happenings arising out of or caused by one event taking place during the term of this contract," the court ruled that the trigger of coverage was the leak or spill that caused the damage rather than the continued leaching or migration of contaminants.\(^{50}\) Because the operations that caused the contamination at the sites that were the subject of the motions ceased long before the inception of the policies that included this language, the court granted defendants' motion for summary judgment under these policies.

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\(^{47}\) *PSE&G*, slip op. at 9-10.

\(^{48}\) *Id.* at 13.

\(^{49}\) *Id.* at 15-17.

\(^{50}\) *Id.* at 11-13.
e. **Scope of Coverage**

The district court deferred a ruling on the scope of coverage issue. It held that this issue turns on whether the property damage had been continuous and indivisible and that issue was to be resolved at trial.\textsuperscript{51}

f. **Late Notice**

The district court denied the insurers, motion for summary judgment on late notice with respect to one of the sites based on the court's conclusion that there had been no showing of prejudice.\textsuperscript{52}

3. **Central Illinois Public Service Co. v. Allianz Underwriters Insurance Co.**

This case was filed by Central Illinois Public Service Co. ("CIPS") in state court in Illinois. CIPS sought coverage for cleanup and defense costs at 15 former MGP sites, including a site in Taylorville, Illinois where CIPS operated a gas plant from 1912 through 1932.

CIPS sought coverage under both CGL policies and Environmental Impairment Liability ("EIL") policies. Summary judgment rulings were issued relating to both types of policies.

A trial limited to EIL issues at the Taylorville site was held in October 1991. The trial court did not allow the CGL insurers to take part in that trial.

After the two week trial on EIL issues and after deliberating for only two hours, an Illinois jury found that CIPS did not expect or intend to discharge contaminants into the groundwater at its Taylorville site.\textsuperscript{53} Several months later, the trial court ruled that CIPS' CGL

\textsuperscript{51} Id. at 18-19.

\textsuperscript{52} Id. at 56-59.

\textsuperscript{53} Mealey's Litigation Reports — Insurance (Nov. 1, 1991), at 3.
insurers were precluded from relitigating the "expected or intended" issue and were bound to the jury verdict in the EIL trial.\footnote{54}

Both the jury verdict and the trial court's ruling that the jury verdict was binding on the CGL insurers were later effectively overturned on appeal.\footnote{55} Nonetheless, there are a number of other rulings in the \textit{CIPS} case that are favorable to policyholders.

\begin{flushleft}
\textbf{a. Jury Verdict and Appellate Reversal}
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The jury verdict in favor of CIPS in the EIL trial was effectively overturned in a decision by the Illinois Court of Appeals. It held that the trial court had erred in ruling that a claim had been made under a "claims made" EIL policy issued to CIPS in 1983 and extending to 1985.\footnote{56} The appeals court found that the term "claim" is not ambiguous and that the date of the actual claim asserted by the state regulatory agency — not the date when CIPS reasonably concluded that a claim was inevitable — was the relevant date for determining coverage.\footnote{57} Since it was undisputed that no claim was made by the state regulatory agency until after the expiration of the policy, the appeals court reversed the trial court and denied coverage as to the one EIL policy at issue.\footnote{58}


\footnote{55} The \textit{CIPS} case has been settled with respect to all but one of the insurers. That remaining insurer was dismissed on late notice grounds. \textit{See} note 71 \textit{infra}.


\footnote{57} \textit{Id.} at E-3 to E-5.

\footnote{58} \textit{Id.} at E-5.
b. Appellate Reversal of Ruling That CGL Insurers Were Bound By EIL Trial Verdict

The trial court's ruling that the CGL insurers were bound by the EIL trial verdict was reversed by the Illinois Supreme Court on due process grounds. Specifically, the Supreme Court found that:

The due process clause requires, at a minimum, that a party have a full and fair opportunity to litigate an issue before he is bound by that issue's resolution. No such opportunity was provided to [the CGL insurers] in this case. To the contrary, [the CGL insurers] were barred from participation [at the trial.]\textsuperscript{59}

The judgments against the CGL insurers were vacated and the case was remanded to the trial court for further proceedings.

\textbf{c. Trigger and Scope of Coverage}

Before the appellate reversal, the trial court, in granting CIPS' post-trial motion for summary judgment on the trigger issue, found that the contamination at the site was "continuous" and "unrelenting\textsuperscript{60}" and that "each policy in effect from 1955 through 1985 must provide coverage."\textsuperscript{61} The court also found that, subject to policy limits and special provisions, each policy "must fully indemnify CIPS for the dollar amounts it has paid to satisfy governmental demands to clean up the environment." \textsuperscript{62}

\textsuperscript{59} \textit{CIPS}, Nos. 73731, 73732 cons., 1994 Ill. LEXIS 27, at *11.


\textsuperscript{61} \textit{Id.} at F-5.

\textsuperscript{62} \textit{Id.}
d. "Property Damage"

In one of a series of summary judgment rulings in the fall of 1991, the circuit court held that "[d]ischarges of pollution into ground or water are damage or injury to tangible property" under the CGL policies at issue.63

e. Pollution Exclusion — "Sudden and "Accidental"

The court also held that "the term 'sudden and accidental' as contained in the pollution exclusion clauses of the general liability policies is ambiguous."64 However, the court refused to grant summary judgment in favor of CIPS because of certain notes written by CIPS' Risk Manager that were arguably relevant to the issue of the parties, intent.65 In the court's view, "the intent of the contracting parties when they agreed on the pollution exclusion clause [was] the essential issue."66

f. Notice and "Known Risk" Doctrine

The court held that AEGIS — a CIPS insurer — waived its right to assert late notice and "known risk" defenses by expressly agreeing to coverage prior to the filing of the insurance coverage lawsuit.67


65 Id. at C-6.

66 Id.

g. "Premises Alienated" Exclusion

In granting CIPS' summary Judgment motion on the "premises alienated" exclusion, the court held that the "premises alienated, clauses [in the CGL policies] do not bar coverage for the cost of cleaning, remediating, mitigating, or preventing further actual or threatened harm to third-person property."68 The court defined "'third-person property' [to] mean the property owned by adjoining owners and the waters, ground or otherwise, on and adjoining the Taylorville site."69 The court concluded that "groundwater is part of the waters of the state."70

h. Notice

The court held that notice was timely as to all of CIPS, insurance carriers with coverage levels of greater than $500,000.71 The court stated that under Illinois law, "[t]he question to be decided is whether the policyholder gave notice . . . within a reasonable time, considering all the facts and circumstances of the case."72 "More leeway is given to the insured where an excess policy is concerned."73


69 Id.

70 Id.


72 Id. at B-1.

73 Id.
The court further noted that under Illinois law "[t]he absence of prejudice does not dispense with the notice requirement." 74

i. "Expected or Intended" Standard

In one of several rulings on various motions for summary judgment concerning the EIL policies, the court held that "[f]or coverage to exist, the emission, discharge, dispersal etc. must have been neither expected nor intended by CIPS." 75 The court found the EIL policy language "clear and unambiguous" on this point. 76

j. "Damages"

The court held that the word "damages" in the CGL policies at issue "can include government-ordered cleanup costs . . . includ[ing] funds expended to mitigate, investigate, correct, or remedy existing or threatened environmental harm to air, ground, or water." 77


This case was filed by Northern States Power Co. ("NSP") in state court in Minnesota. NSP operated a manufactured gas plant in Faribault, Minnesota in the early 1900s. The trial court issued summary judgment rulings on a number of issues, and appeals were taken.

74 Id.
76 The court also ruled that timely notice was provided under CIPS' EIL policies and that the waste disposal site exclusion in the policies was ambiguous and did not apply to the incident at issue. Id. at D-2 to D-7.
NSP had settled with 13 of its 14 insurance carriers before decisions were issued in the case by the Minnesota Court of Appeals and the Minnesota Supreme Court.78

a. Primary Versus Excess Coverage

In holding that the remaining insurance policies provided primary coverage, the Minnesota Court of Appeals "examin[ed] the total policy insuring intent, as determined by the primary function of the policy and primary policy risks upon which the premiums were based."79 The court found that the defendant insurer "intended to provide the first layer of coverage subject to NSP's self-insured retentions."80

The court also noted that "[c]omparing other insurance, clauses in policies providing coverage over different time periods may lead to inequitable results . . . . It is unfair for a later carrier to provide . . . coverage [for] damages it believed were covered by earlier policies [like the policies in question]."81

The Minnesota Supreme Court affirmed the Court of Appeals' result on this issue on other grounds, noting that there was no "other insurance" in effect during the time a policy issued by the defendant insurer was in effect.82

79 Id. at E-3.
80 Id. at E-4.
81 Id.
82 Northern States Power Co. v. Fidelity & Casualty Co., 523 N.W.2d 657, 664 (Minn. 1994).
b. Trigger of Coverage

In concluding that coverage under the insurance policies at issue was triggered, the Minnesota Court of Appeals relied on the district court's finding on summary judgment "that there was one ongoing occurrence and that the actual injury was continually manifested during the [relevant] policy periods."83

c. "Damages Because of Property Damage"

The Court of Appeals concluded that "][m]andated expenditures necessary to clean up the groundwater and the contaminated soil causing the groundwater pollution and other expenses causally related to remedying the groundwater pollution are covered [as] damages because of property damage."84 The court did note, however, that "not all expenditures mandated by the [state regulatory agency] are necessarily covered under a general liability policy."85 While "][c]osts and expenses for cleanup of pollution that is already present are covered, . . . [e]xpenditures to prevent future pollution of a type which has yet to occur or from a source which has yet to cause pollution . . . are not covered."86 The Court of Appeals then remanded the case for the trial court to make the necessary factual findings to determine whether the costs at issue were covered under this legal standard.

d. Owned-Property Exclusion

The Court of Appeals further concluded that costs incurred to remedy groundwater pollution are not subject to the owned-property exclusion because groundwater

84 *Id.* at E-5 to E-6.
85 *Id.* at E-5.
86 *Id.*
contamination is damage to public property, not "injury to or destruction of... property owned by the Insured." Under this rationale, "cleanup expenses needed to correct already existing soil contamination which continues to damage the groundwater" are covered, while "[m]andated expenses remedying problems confined on NSP's property that do not rectify the groundwater and associated soil contamination [are not]." The case was remanded for factual determinations on this point.

**e. Allocation of Damages and Deductibles**

NSP argued that its insurers were "concurrently liable and damages should be prorated according to the policy limits." The defendant insurer responded that the policies should be stacked "according to the total policy insuring intent to allocate damages."

After analyzing these arguments, the Minnesota Court of Appeals held that damages resulting from contamination were to be allocated "based on the percentage of property damage that occurred when [the defendant insurer] provided coverage" and remanded the case for factual determinations on this point. The court concluded that "NSP is required to pay one deductible for each policy under which it is invoking coverage."

The Minnesota Supreme Court modified this ruling by adopting a "pro rata by time on the risk" method of allocating damages. Under this method, "the contamination of the

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87 Id. at E-6.
88 Id. at E-6 to E-7.
89 Id. at E-7.
90 Id.
91 Id. at E-7.
92 Id. at E-8.
93 Northern States Power Co. v. Fidelity & Casualty Co., 523 N.W.2d 657, 663-64 (Minn. 1994). The Minnesota Supreme Court accepted the court of appeals' analysis regarding trigger of (continued...)
groundwater should be regarded as a continuous process in which the property damage is evenly distributed over the period of time from the first contamination to the end of the last triggered policy (or self-insured) period, and . . . the total amount of the property damage should be allocated to the various policies in proportion to the period of time each was on the risk."94


This case was filed by Stone & Webster in the United States District Court for the Southern District of New York. Stone & Webster sought a declaratory judgment that its insurers were obligated to defend lawsuits seeking cleanup costs at former MGP sites.

a. Occurrence

The court held that environmental contamination can be a continuous, progressive process beginning upon initial release of the contaminants and continuing until the contaminants are removed. The court observed that, as a factual matter, groundwater migrates and contaminants can form plumes that expand over time."95

b. Owned Property Exclusion

The court ruled that the owned-property exclusion would not bar coverage for off-site damage, such as damage from seeping pollution to the soil, sediment, and groundwater of an

coverage, "damages because of property damage," and the "owned-property" exclusion. Id. at 660-62.

94 Id. at 664. The Minnesota Supreme Court further explained: "If, for example, contamination occurred over a period of 10 years, 1/100th of the damage would be allocable to the period of time that a policy in force for 1 year was on the risk and 3/10ths of the damage would be allocable to the period of time a 3-year policy was in force."

adjacent river. The court did not rule on whether the owned-property exclusion would exclude coverage for on-site property damage.

c. Expected or Intended

The pollution exclusion in the policies in dispute provided that coverage would not apply to release or escape of pollutants where the release was "expected or intended" by the insured. The court held that since the complaints in the underlying litigations did not state or imply that the release of MGP wastes at the sites was expected or intended, the insurer would not be relieved of its duty to defend.

d. Notice

Travelers contended that Stone & Webster had failed to provide timely notice to the insurer because Stone & Webster had prior knowledge of environmental cleanup problems at MGP sites. The court held that knowledge in general of potential liability at MGP facilities is not knowledge of an occurrence at a particular site.

6. Vermont Gas Systems, Inc. v. USF&G

This case was filed by Vermont Gas Systems ("VGS") in the United States District Court for the District of Vermont. VGS operated a manufactured gas plant in Burlington, Vermont from 1964 through 1966.

a. Pollution Versus Damage

In an opinion on summary judgment, the district court rejected the argument of VGS's insurers that "if pollution is apparent before the inception of an insurance policy, there can

96 Id. at *36-37.
97 Id. at *40-42.
98 Id. at *55.
be no coverage under that policy for claims related to that pollution."\textsuperscript{99} The court noted that the case cited by the insurers in support of their argument actually "hinged on when damage occurred or was apparent, not when pollution was apparent."\textsuperscript{100} In any event, the court ruled that the issue of when pollution was apparent was a fact-specific one that would have to be resolved at trial, rather than on summary judgment.\textsuperscript{101}

\textbf{b. Notice and Duty to Defend}

In granting VGS's motion for partial summary judgment on the duty to defend, the court held that VGS's insurers had an initial duty to defend VGS even though those insurers contended that they had not received timely notice.\textsuperscript{102} The court "agree[d] with the proposition that [under Vermont law] if VGS cannot prove timely notice its coverage will be forfeited without regard to prejudice."\textsuperscript{103} However, the court noted that "there may be circumstances that will explain or excuse a delay."\textsuperscript{104} The court stated that more facts were needed before it could decide whether VGS's delay in notifying its insurers was excusable.\textsuperscript{105} In the meantime, the court ruled that the insurers had an obligation to defend VGS.

\begin{flushleft}
\textsuperscript{100} \textit{Id.} at C-4 (emphasis in original).
\textsuperscript{101} \textit{Id.} at C-4 to C-5.
\textsuperscript{103} \textit{Id.} at 232.
\textsuperscript{104} \textit{Id.} at 232 n. 8 (citation omitted).
\textsuperscript{105} \textit{Id.} at 232.
\end{flushleft}

This case was filed by Puget Sound Power & Light Co. (11PSPL11) in the United States District Court for the Western District of Washington. PSPL had sent MGP wastes to the Tacoma Tar Pits site in Washington.

a. Duty to Defend and Allocation of Defense Costs

In a 1993 opinion, the district court held that two of PSPL's insurers had breached their duty to defend PSPL and were each jointly and severally liable for all of PSPL's defense costs.106 The court observed that neither the underlying EPA complaint nor the complaint in the third-party action "Provide[d] any details about the timing or nature of [PSPL's] deliveries of hazardous materials to the Tar Pits."107 Thus, there was "no rational basis for apportioning defense costs."108 Under Washington law, "'when an insurer wrongfully refuses to defend and there is no reasonable means of prorating the costs of defense between those items that are covered and those that are not covered, the insurer is liable for the entire cost of the defense.'"109

This decision was affirmed by the U.S. Court of Appeals for the Ninth Circuit in an unpublished opinion.110 The insurer, which had been on the risk for only three years, argued for a time-on-the-risk method of allocating the costs of defense."111 The Ninth Circuit rejected


107 *Id.* at E-4.

108 *Id.*

109 *Id.* at E-3 (citation omitted).


111 *Id.* at G-2.
this proration method because it was a not a reasonable means of approximating the extra cost of defending PSPL on matters outside the insured years.\textsuperscript{112}

8. \textit{Public Service Co. of Colorado v. Certain Underwriters at Lloyd's London}

This case was filed by Public Service Company of Colorado ("PSC") in state court in Colorado. Public Service sought coverage for the cleanup costs for a landfill, a scrapyard, and a former MGP.

\textbf{a. Jury Verdict}

PSC discovered on-site contamination at the former MGP site in June 1989, and thereafter began remedial activities, but did not notify its insurer of the claim until March 1992.

The jury found that an occurrence took place at the former MGP site, and that policies from 1955 to 1977 would be triggered. However, the jury found also that PSC did not provide timely notice and had no justifiable excuse for not doing so. Accordingly, coverage was denied for the MGP site.

With regard to the two non-MGP sites, the jury ruled that PSC's notice was timely, there had been an occurrence, the relevant policies were triggered, and that PSC had not expected or intended the property damage. The jury awarded a verdict to PSC of $4.2 million, and the case is now on appeal.


This case was filed by Chesapeake Utilities Corp. ("Chesapeake") in the United States District Court for the District of Delaware. Chesapeake's predecessors operated two

\textsuperscript{112} \textit{Id.}
MGPs — one in Maryland and one in Delaware. These plants were dismantled between 1948 and 1950.

a.  "As Damages"

In denying the insurers, motions for summary judgment, the district court held that under both Maryland and Delaware law, the term "damages" does not exclude cleanup costs.\(^{113}\)

b.  "Operations"

The court rejected the insurers, argument that the term "operations" as used in several of the insurance policies at issue "[could not], as a matter of law, include Chesapeake's disposal of coal tar."\(^{114}\) The court held that the interpretation of the term "operations" was a factual question involving the intent of the contracting parties, and must therefore await resolution at trial.\(^{115}\)


This case was filed by Pacific Gas and Electric Co. ("PG&E") in a California state court. Thirty-seven former manufactured gas plant sites in California are at issue.

a.  Duty to Defend

In granting PG&E's motion for summary adjudication, the court held that the defendant insurers had a duty to defend PG&E for thirty-two sites in which a lawsuit had already

\(^{113}\)  *Chesapeake Utils. Corp. v. American Home Assurance Co.*, 704 F. Supp. 551, 561, 565 (D. Del. 1989). The court also rejected the insurers' argument that under Maryland law, environmental response costs are not "property damage". *Id.* at 565-66 & n.32.

\(^{114}\)  *Id.* at 564. The policies at issue required the defendant insurers to pay "all sums which the insured shall become obligated to pay by reason of liability for damages because of injury to or destruction of property . . . arising out of the operations of the insured as defined herein." *Id.* at 561. (emphasis in original).

\(^{115}\)  *Id.*
been filed or a Federal or State agency order or request to investigate and remediate environmental damage had been entered.\textsuperscript{116} The court concluded that agency orders and requests, while "not technically lawsuits', . . . fit into the concept of 'litigation, involving a 'claim' covered by policies in this case.\textsuperscript{117}

The court denied PG&E's motion for summary adjudication regarding the duty to defend as to one site where tender had not been made and four sites where settlements had been reached (though the court held that PG&E was entitled to post-tender investigation and defense costs for the settled sites).\textsuperscript{118} The court also denied PG&E's motion as to two policies that the court held did not include or imply a duty to defend.\textsuperscript{119}

\textbf{b. Joinder of Excess Carriers}

The excess insurers sought to be dismissed as defendants in PG&E's comprehensive coverage action on the ground that PG&E's underlying policies of insurance had not been exhausted. The court held that PG&E, by alleging a reasonable possibility of exhaustion, had met the burden of alleging that its primary policies may be exhausted, and therefore the excess carriers should be joined in the suit.\textsuperscript{120}


\textsuperscript{117} Id. at 5.

\textsuperscript{118} Id. at 6.

\textsuperscript{119} Id. at 5-6.

D. Rulings Generally Unfavorable to Policyholders

1. Atlanta Gas Light Co. v. Aetna Casualty & Surety Co.

This case was filed by Atlanta Gas Light Company ("AGL") in the United States District Court for the Northern District of Georgia. AGL owned and operated MGPs in Florida and Georgia from 1848 until 1954.

The district court granted summary judgment for the insurers on the issue of timeliness of notice. On appeal, the U.S. Court of Appeals for the Eleventh Circuit vacated the grant of summary judgment on the ground that no justiciable controversy existed at the time AGL filed suit against its insurers.\(^{121}\) AGL had filed its declaratory judgment action before the insurance companies received the notice of potential liability that AGL mailed to them the previous day.\(^{122}\) The court ruled that because AGL's insurers had not been given the opportunity to respond to the notice of potential liability, AGL's declaratory judgment action presented conjectural issues that were not ripe for decision.\(^{123}\)

The district court had previously dismissed all of AGL's insurance coverage claims, ruling that AGL failed to give its insurers timely notice of an occurrence under the policies issued to AGL.\(^{124}\) The district court specifically found that "AGL knew [several years before giving notice to its insurers] that its potential liability was in the millions of dollars and

\(^{121}\) Atlanta Gas Light Co. v. Aetna Casualty & Sur. Co., 68 F.3d 409 (11th Cir. 1995).

\(^{122}\) Id. at 414-15.

\(^{123}\) Id. at 415.

further knew that its potential liability exceeded the coverage provided by its self insurance
retention fund and . . . direct insurance carrier.\textsuperscript{125}

In addition, the district court concluded that under Georgia law, the insurers were
"not required to show that they were prejudiced by such untimely notice."\textsuperscript{126}

The Eleventh Circuit never reached the issue of timeliness of notice.

\textbf{2. Union Gas Co. v. Aetna Casualty & Surety Co.}

This case was filed by Union Gas Co. ("Union Gas") in the United States District
Court for the Eastern District of Pennsylvania. Union Gas's predecessors manufactured gas at a
site in Stroudsburg, Pennsylvania in the early 1900s.

\textbf{a. Jury Verdict}

A jury found that the contaminating incidents at issue were unintended,
unexpected and accidental, but were not "sudden and accidental" under the pollution exclusion
language of the policies.\textsuperscript{127} This verdict released the defendant insurer from any coverage
obligations.\textsuperscript{128}

\textbf{3. City of St. Petersburg, Florida v. USF&G}

This case was filed by the City of St. Petersburg, Florida ("the City") in the
United States District Court for the Middle District of Florida. The City operated a
manufactured gas plant from 1914 through 1954.

\textsuperscript{125} Order at 6 (Aug. 13, 1993).
\textsuperscript{126} Order at 4 (Oct. 8, 1993).
\textsuperscript{127} Mealey's Litigation Reports – Insurance (May 26, 1987), at 4360-62.
\textsuperscript{128} \textit{Id.}
a. Pollution Exclusion/Duty to Defend

In granting the insurer's motion for summary judgment, the court held that the insurer had "no duty to defend the City under [the primary policy at issue] because the pollution damage was not sudden or accidental," within the meaning of the exception to the pollution exclusion in the policy.\textsuperscript{129} The plaintiffs in the underlying action complained of illnesses and other related problems as the result of exposure to contamination "occurring on the [MGP] site over an extended period of time."\textsuperscript{130} The court relied on the fact that under Florida law, "the term 'sudden' includes a temporal aspect with a sense of immediacy or abruptness," and thus did not apply to gradual pollution.\textsuperscript{131}

The court also held that the insurer did not have a duty to defend the City under the excess policy at issue, which contained an absolute pollution exclusion.\textsuperscript{132}

E. Summary

The case law on insurance coverage for MGP costs is still evolving. But most of the courts that have addressed the issue have ruled in favor of coverage.

II. RATE RECOVERY OF NET MGP COSTS

Another possible means for recovering MGP costs is through the utility's rates. This article next outlines the arguments typically made for and against the full recovery from ratepayers of net MGP costs, and then summarizes the reported decisions of public utility commissions on the recovery of such costs, with particular emphasis on recent decisions.


\textsuperscript{130} \textit{Id.} at E-1, E-2, and E-5.

\textsuperscript{131} \textit{Id.} at E-4 to E-5.

\textsuperscript{132} \textit{Id.} at E-6.
The commission decisions on rate recovery of net MGP costs fall into three general categories: (1) those granting full recovery of net MGP costs from ratepayers through base rate treatment or trackers; (2) those granting only partial recovery of such costs; and (3) those denying all recovery of net MGP costs (of which there is only one). A majority of the commissions that have addressed the issue in contested cases have ruled in favor of full recovery.

A. Arguments For and Against Allowing Full Recovery of Net MGP Costs From Ratepayer

Proponents of the full recovery of net MGP costs from ratepayers typically make the following arguments. First, they assert that the costs of investigating and remediating MGP sites — which are incurred in response to claims made under recently enacted statutes that impose strict retroactive liability — are costs of resolving claims that are necessary to remaining in business and thus to providing current service to customers; like other costs of providing current service, they are properly recoverable in rates, unless found to be imprudently incurred. Second, they assert that full recovery of net MGP costs serves the best interest of the public — including the utility's ratepayers — by encouraging the utility to conduct prompt and thorough investigations and cleanups of environmental conditions at MGP sites. Third, they assert that the historical stewardship of MGP sites was prudent, because the historical operating and waste disposal practices at those sites were in accord with common gas industry practices at the time. Fourth, they assert that the prospect of regular prudence reviews creates a sufficient incentive for the utility to manage its cleanups efficiently and to aggressively pursue recoveries from insurers and other third parties.

Those opposing the full recovery of net MGP costs from ratepayers typically respond in the following manner. First, they assert that net MGP costs are not related to the cost of providing service to current customers but rather to past operations, and therefore the recovery
of such costs would be retroactive ratemaking. Second, they argue that current customers do not
directly benefit from net MGP costs. Third, they assert that sharing is necessary to provide the
utility with sufficient incentives to perform MGP cleanups efficiently and to maximize
recoveries from insurers and other third parties. Fourth, they assert that net MGP costs should be
disallowed because the utility acted unreasonably in its operating and waste disposal practices
during the MGP era. Finally, they assert that, for those jurisdictions where any appreciation in
the value of utility property goes to the shareholders when the property is sold, it is only fair to
require the shareholders to share in the net MGP costs.

B. Commission Decisions Granting Full
Recovery of MGP Costs From Ratepayers

The majority of state commissions that have addressed the issue of rate recovery
of net MGP costs in contested cases have granted full recovery from ratepayers through base rate
treatment or trackers. The reported commission decisions granting full recovery are summarized
below, with an emphasis on the most recent decisions.

1. ICC v. Illinois Power Company,
   1996 Ill. PUC LEXIS 53 (1996)

In January 1996, the Illinois Commerce Commission (ICC) permitted full
recovery of all prudently-incurred MGP remediation costs, including carrying charges. This
decision came on remand from the Illinois Supreme Court, which had affirmed in part and
reversed in part a generic investigation into MGP cost recovery initiated by the ICC in 1992. In the 1992 generic inquiry, the ICC had allocated MGP cleanup expenses between ratepayers
and shareholders through a five-year recovery period, with no carrying charges on the

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133 Citizens Util. Bd. v. Illinois Commerce Comm’n, 651 N.E.2d 1089 (Ill. 1995), reh’g
denied (May 30, 1995).
unamortized balance. The Illinois Supreme Court reversed the ICC with respect to the cost-sharing issue, finding that the ICC had failed to articulate a reasoned basis for its departure from its longstanding position that all mandatory operational expenses are recoverable.

In the 1992 generic inquiry, the ICC had determined that MGP cleanup expenses would be afforded a rebuttable presumption of prudence in future rate cases. In reaching this conclusion, the ICC rejected arguments that utilities had acted imprudently in their past operation of MGP facilities and that the recovery of MGP remediation expenses bore no relationship to the provision of current service. With regard to the latter conclusion, the Illinois Supreme Court affirmed that "the cost of delivering utility service reasonably encompasses current costs of doing business, including necessary costs of complying with legally mandated environmental remediation." The Court also upheld the ICC's authority to permit MGP cost recovery through the use of a rider mechanism.


The New Jersey Board of Regulatory Commissioners issued this ruling in a contested rate proceeding involving the recovery by Public Service Electric & Gas Co. ("PSE&G") of the costs of investigating and remediating 38 sites at which gas was manufactured and one site at which gas plant wastes were disposed.


135 651 N.E. 2d at 1096.
Rejecting the arguments of New Jersey's Public Advocate that, in accordance with precedent, the costs should be shared equally between ratepayers and shareholders, the Board held that "PSE&G has made a convincing case that the reasonable and prudent costs associated with the remediation of its MGP sites should be recovered from ratepayers." The Board approved the following recovery mechanism: PSE&G is authorized to amortize over a seven-year period the reasonable and prudent net costs incurred each year in connection with its MGP cleanup program, and to recover those amortized costs, including carrying charges at an interest rate equivalent to the Company's cost of intermediate-term (7-year) debt (less the benefit of deferred taxes), through remediation adjustment clauses.

With respect to the company's historical stewardship of the MGP sites, the Board ruled:

With respect to cleanup of the MGP sites, the Board believes that PSE&G has demonstrated the prudence and reasonableness of its conduct, both in operating and decommissioning the MGP sites in the past, as well as investigating and remediating the sites currently. The record indicates that the Company's historical operating practices were consistent with then-prevailing industry practices . . . . The Board believes that the Company's past actions as to the operation and decommissioning of these sites must be measured against practices acceptable at the time in question. To do otherwise would penalize the Company for

136 The Board had previously approved settlements for South Jersey Gas Company and New Jersey Natural Gas Company that provided for an amortization of MGP costs over seven years, without carrying charges.


138 Id. at 14-21. The Board also required that PSE&G's gas customers provide 60 percent of the net cleanup costs and that its electric customers provide 40 percent of the net cleanup costs. This issue of rate responsibility as between gas and electric customers of a combined utility has also been raised in other jurisdictions. See, e.g., New York State Elec. & Gas Corp., 90 PUR4th 322 (N.Y. Pub. Serv. Comm'n 1988) (sharing MGP cleanup costs between gas and electric customers).
lacking the prescience to conform to today's ever-exacting environmental standards.\textsuperscript{139}

Thus, no costs were disallowed on grounds of imprudence.

In rejecting the Advocate's argument that carrying costs should not be allowed, the Board cited a number of reasons: (1) environmental cleanup costs are "viewed as being a necessary and ongoing cost of doing business;"\textsuperscript{140} (2) the need for, and parameters of, the MGP site cleanups had been mandated by the State; (3) PSE&G had acted prudently both in MGP operations and remediation, and in "aggressively pursuing insurance recoveries;"\textsuperscript{141} (4) the allowance of carrying costs at a debt rate yields no return to shareholders; and (5) periodic prudence reviews would provide a greater incentive for PSE&G to carry out its MGP cleanups efficiently than would arbitrary restrictions on cost recovery.\textsuperscript{142}


In this case, the District of Columbia Public Service Commission granted full recovery of MGP cleanup costs for one site, but reserved the option of requiring shareholders to bear part of the cleanup costs under undefined conditions in future cases.

\textsuperscript{139} \textit{Id.} at 14.
\textsuperscript{140} \textit{Id.} at 16. The Board emphasized that remediation costs arise out of recently-enacted environmental standards, not out of any failure to meet standards applicable during the MGP era:

Additionally, the fact that remediation costs were not provided for in rates when they were incurred is less a basis for denying cost recovery than it is an indication of the fact that environmental awareness of the kind evident today was unknown at that time.

\textit{Id.} at 17.
\textsuperscript{141} \textit{Id.} at 18.
\textsuperscript{142} \textit{Id.} at 15-18. To facilitate these periodic prudence reviews, the Board adopted detailed auditing and verification measures, \textit{id.} at 20, and stressed that it "will be vigilant in its oversight of the Company's remediation programs." \textit{Id.} at 15.
The Commission observed that there were clearly advantages to District of Columbia ratepayers from the cleanup and that the company had been prudent and reasonable in its operations. The Commission set forth a general rule for when it would allow recovery of MGP cleanup costs: "when: (1) the costs are necessary; (2) the costs are prudently incurred; (3) the Commission has the opportunity to review the Company's actions during a general rate case; and (4) . . . ratepayers have an opportunity to share in monetary benefits which may accrue from an environmental cleanup that enhances the value of the property.\(^{143}\)

The Commission granted amortization of identified cleanup costs over a three-year period, requiring appropriate adjustments for any tax benefits and carrying costs applied to the unamortized rate base portion in conformance with the company's overall rate of return. The Commission also required that, if the subject property was ever sold or leased, the ratepayers should share in any profits. The Commission was not specific in how such sharing should occur, except to say the ratepayers should receive at least 50 percent of any net revenues from the remediated property. The parties and Staff were directed to submit proposals in the company's next rate case on how to implement this revenue sharing mechanism.

Future cleanup costs were to be recorded in a deferred account and addressed in the company's next rate case.

\(^{143}\) 146 PUR4th at 503.
4. **Michigan Gas Utilities, Case**  
**No. U-10503, 1994 Mich. PSC**  

In this brief decision, the Commission followed its prior rulings and approved the company's proposal for deferred accounting of MGP cleanup costs, which would be amortized over a ten-year period, taking into account any reimbursement of costs from insurance companies or other third parties.\(^{144}\) If the Commission finds the costs prudently incurred, the company will accrue carrying charges on the unamortized balance at the company's overall pre-tax rate of return by including the unamortized balance in its rate base.\(^{145}\)

5. **Earlier Decisions Providing Full Recovery**

The following earlier decisions also granted full recovery from ratepayers:

- **Yankee Gas Services Co.,** Docket No. 92-02-19, 1992 WL 333210 (Conn. Dept. Pub. Util. Control, Aug. 26, 1992) (prudently incurred MGP cleanup costs allowed as proper operating expenses; recovery via five-year amortization, with unamortized amounts included in rate base; rate of return equal to short-term cost of debt);
- **Midwest Gas,** 133 PUR4th 380 (Iowa Util. Bd. 1992) (accepting cleanup costs as current and legitimate costs of doing business; recovery of costs by inclusion of representative amount in base rates);

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\(^{145}\) However, the Commission apparently would not allow the carrying charge to accrue until after the Commission had found the costs to be prudently incurred in a rate case. See **Michigan Consol. Gas Co.,** 1993 Mich. PSC LEXIS 230, 147 PUR4th 1 (Mich. Pub. Serv. Comm'n, Oct. 28, 1993) (amortized costs over ten years, with carrying charges at the pre-tax authorized rates, but amortization was to begin only after a prudence review in a rate case).
rate base, adjusted to reflect any insurance recoveries);\textsuperscript{146} Chesapeake Utilities Corp., Order No. 68462, 1989 Md. PSC LEXIS 81 (Md. Pub. Serv. Comm'n, June 9,'1989) (amortized cleanup costs over ten years, with unamortized amounts in rate base to cover carrying costs) (followed in Washington Gas Light Co., 84 MD PSC 401, 1993 WL667150 (Nov. 12, 1993)); and Peoples Gas System Inc., Order No. 16313, 1986 Fla. PUC LEXIS 586 (Fla. Pub. Serv. Comm'n, July 8, 1986) (accepting cleanup costs as "normal ongoing, utility business expenses"; amortization over five years, with unamortized amounts in rate base).\textsuperscript{147}

C. Commission Decisions Requiring Sharing of Net MGP Costs Between Shareholders and Ratepayers

A minority of commissions that have addressed this issue in contested cases have ruled that utility shareholders and ratepayers must share net MGP costs through amortization without carrying costs, while several jurisdictions have approved settlements that embody some aspect of sharing of net MGP costs.


In this general rate case, the North Carolina Utilities Commission rejected the company's request to use a tracker to recover all cleanup costs associated with six former MGP

\textsuperscript{146} The New York Public Service Commission has continued to allow Full cost recovery. See National Fuel Gas Distrib. Corp., 153 PUR4th 523 (N.Y. Pub. Serv. Comm'n, 1994). However, it has recognized that further consideration of cost sharing may be appropriate in light of possible difficulties in evaluating prudence and to ensure appropriate incentives for cost controls on clean-up efforts. See id.

\textsuperscript{147} There are also earlier decisions in California that granted full recovery. See, e.g., Southern California Edison Co., Decision No. 9112076, 1991 Cal. PUC LEXIS 911 (Cal. Pub. Util. Comm'n, Dec. 20, 1991) ("costs recovered entirely from ratepayers," using combination of base rate treatment and special accounting mechanism). In California, however, full recovery has been replaced with a sharing mechanism pursuant to a settlement agreement. See section II.D., infra.
sites. The Commission instead opted for deferral and amortization of actual costs, denying recovery of carrying costs on the deferred or unamortized balances. Actual costs incurred to date were amortized over three years. The length of amortization for future costs would depend on the circumstances, including the magnitude of the costs involved.

The Commission identified several reasons for this result. First, amortization was seen as providing more stable rates than the tracker. Second, treating the costs in a rate case would afford a better opportunity for prudence review of the MGP costs than would a tracker. Third, the Commission was concerned that the tracker's cost pass-through would remove the utility's motivation to minimize cleanup costs and to pursue contributions from insurers and potentially responsible third parties. Finally, the Commission believed that some degree of sharing of cleanup costs between ratepayers and shareholders was appropriate. On the one hand, the Commission recognized that it was "proper and in the public interest" for the utility to recover "prudently-incurred cleanup costs from current ratepayers as reasonable operating expenses, even though the MGP sites are not used and useful" for current services.\textsuperscript{148} And on the other hand, the Commission found that "it is not appropriate for ratepayers to relieve shareholders of all cost responsibility associated with the ratemaking treatment of MGP cleanup."\textsuperscript{149} The Commission found further support for this result in decisions of other commissions where MGP cleanup costs had been shared and by viewing the situation to be analogous to its treatment of costs associated with abandoned nuclear power plants.

\textsuperscript{148} 156 PUR4th at 402.
\textsuperscript{149} \textit{Id.}

In this decision, on motion to reconsider, the Commission reaffirmed its requirement that the utility shareholders bear 40 percent of the investigation and cleanup costs related to MGPs, with the ratepayers bearing 60 percent of the costs. The Commission dismissed the utility's arguments that the subject property was currently being used in company operations — as the sites of a warehouse, garage, storage, operations facilities, and parking lot. Rather, the Commission found that the costs related to the cleanup do not relate to current services, but are a result of the former MGPs which are no longer providing services to customers. It also found that the ratepayers will not receive a current or future benefit from the remediation costs.

Relying on its broad authority to establish rates and balance the interests of ratepayers and shareholders, the Commission ordered that the utility record actual remediation costs into a deferred account, subject to approval at the utility's next rate case. The approved costs will be amortized over ten years without carrying charges. The Commission granted the utility 40 percent of any insurance recoveries, as an intended incentive to pursue such recoveries aggressively. Finally, the Commission required that any gain from the sale of remediated property be shared between ratepayers and shareholders, based on a prior decision regarding capital gains, which would give shareholders less than 30 percent of any such gain.


In this case, which involved estimated cleanup costs in excess of $80 million projected over 35 years, the Wisconsin Commission acknowledged that the MGP cleanup was required under current law, and, from that perspective, the cleanup costs are current and legitimate expenses reasonably incurred and therefore subject to recovery from ratepayers.
However, the Commission also found that the MGPs had been removed from service over 40 years ago, that current ratepayers received no benefit from manufactured gas and that the cleanup costs were not related to the provision of service to current customers. The Commission also noted that in Wisconsin the profit (or loss) on the sale of land goes exclusively to the shareholders. Thus, any increase in land value resulting from the remediation of the MGP sites, even if paid for by the ratepayers, would accrue solely to the shareholders' benefit.

Citing its obligation to balance the interests of ratepayers and shareholders, the Commission found that sharing of cleanup costs would be reasonable and just. Sharing would be achieved by deferred accounting of the cleanup costs, which would then be recovered in rates over a five-year period, with no recovery of carrying costs on the unamortized balances. The cleanup costs were to be netted against insurance and third-party recoveries, which the Commission viewed as an incentive for the company to pursue such recoveries vigorously and thereby limit the cleanup costs for which it received no carrying costs.

4. **Earlier Decisions Requiring Sharing of Net MGP Costs Between Shareholders and Ratepayers**

The following earlier decisions in contested rate proceedings required shareholders to bear part of the net MGP costs: *Northern States Power Co.*, Nos. G-002/GR-86-160; G-002/M-86-165, 1987 Minn. PUC LEXIS (Minn. Pub. Util. Comm'n, Jan. 27, 1987) (cleanup costs amortized over five years, but unamortized amounts not included in rate base); More recently, in *Interstate Power Company*, Docket No. G-001/GR-95-406 (Feb. 29, 1996), the Minnesota Public Utilities Commission overruled an ALJ's decision to impose a 50% sharing of costs and authorized full recovery. The Commission did not, however, authorize carrying charges on the unamortized balance, thus resulting in some *de facto* sharing of costs.

The following decisions have approved settlements in which companies agreed that their shareholders would bear part of the net MGP costs: *Energy North Natural Gas, Inc.*, DE 93-168, 1993 WL733960 (N.H.P.U.C. Nov. 22, 1993) (approving settlement with seven year amortization, but without carrying costs or rate base treatment, noting that "some sharing of the burden between ratepayers and shareholders may be appropriate"); *Atlanta Gas Light Co.*, No. 4167-U (Ga. Pub. Serv. Comm'n, Sept. 1, 1992) (five-year amortization, deferred tax benefits to ratepayers, carrying costs on unamortized amounts not allowed, but company allowed to retain one-half of insurance and third-party recoveries, up to amount of carrying costs); and *Generic Investigation Into Ratemaking Treatment for Remediation of Hazardous Waste From the Manufacture of Natural Gas*, No. 89-161, Mass. D.P.U. (May 25, 1990) (abstract at 115 PUR4th 275) (amortize costs over seven years, without carrying costs, but company allowed to retain one-half of net insurance or third-party recoveries, towards its share of the cleanup costs).151

**D. The California MGP Rate Settlement**

Early California decisions addressing MGP cleanup costs provided for full recovery of prudent and reasonable net MGP costs from ratepayers. In a rather complicated system, a utility could maintain deferred accounting of net remediation costs, which would later

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151 As noted above, the New Jersey Board of Regulatory Commissioners has also approved two settlements that provide for amortization of net MGP costs without carrying costs. *South Jersey Gas Co.*, Order Adopting Stipulation, Docket No. GR91071243J (Aug. 10, 1992) (amortize net MGP cleanup costs over seven years, no carrying costs on unamortized costs, and tax benefits allocated to ratepayers); *New Jersey Natural Gas Co.*, Order Adopting Partial Initial Decision, Docket No. GR91081393J (June 24, 1992) (same). But as further noted above, the Board has since ruled in a contested proceeding in favor of full recovery of net MGP costs from ratepayers. *Public Serv. Elec. & Gas. Co.*, BRC Docket No. ER91111698J, slip op. at 14-21 (amortization over seven years with carrying charges).
be reviewed for reasonableness, and all reasonable costs could be recovered through the rates, with all carrying costs and appropriate rate of return included. However, in November 1992, the California Public Utilities Commission invited comments and suggestions for alternative mechanisms to recover MGP costs, including sharing between ratepayers and shareholders.  

After extensive negotiations between the major utilities and the ratepayers' advocates, a settlement proposal was reached, although not signed by one ratepayer advocate group. The settlement, outlined below, was approved without change by the California Commission on May 4, 1994.

The California settlement calls for ratepayers to bear 90 percent, and shareholders to bear 10 percent, of the MGP costs. But the settlement also allows shareholders to recover their share of the MGP costs from insurance coverage or other third-party recoveries, and possibly to recover even more than their share. Insurance litigation costs are allocated 70 percent to ratepayers and 30 percent to shareholders, and insurance recoveries are allocated in the same manner until both groups are made whole for their insurance litigation costs. Any remaining insurance recoveries are then allocated 10 percent to ratepayers and 90 percent to shareholders, until the shareholders recover their share of the MGP costs. If, after that, there are still insurance recovery funds remaining, those funds are allocated 60 percent to ratepayers and 40 percent to

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154 If the costs are below $5 million for an 84-month period, ratepayers will be responsible for 95 percent and shareholders for 5 percent of the remediation costs.
shareholders. As to third-party recoveries, all related litigation costs and recoveries are allocated 90 percent to ratepayers and 10 percent to shareholders.

The settlement precludes any reasonableness review for the cleanup costs, litigation costs and recoveries, or associated activities. The cleanup costs are recorded in interest-bearing accounts, created specifically to record these costs. The utility will then recover the properly recorded costs in a subsequent proceeding or proceedings as it deems appropriate.

In approving the settlement, the California Commission rejected comments from the one objecting ratepayer advocacy group, which urged a 50/50 sharing of costs between ratepayers and shareholders. The Commission recognized that the allocation percentages were a matter of judgment and concluded the 90/10 allocation would provide sufficient incentive to utility management to pursue efficient remediation and recovery of insurance coverage. The Commission made particular note that the utilities should aggressively pursue recovery from their insurers:

> We believe the primary responsibility for paying for hazardous substance expenses should fall on the insurers under the policies issued by them to the utilities over the years. The purpose of having utilities obtain insurance coverage is to ensure that neither the ratepayers nor the utilities have to bear the expense of liability or losses.  

E. **The Indiana Decision Denying Recovery of MGP Costs**

The Indiana Utility Regulatory Commission (IURC) is, to date, the only state commission that has completely denied recovery of MGP costs. The IURC found that the MGP costs at issue "were not sufficiently related to the provision of public utility service as to merit recovery." In reaching that conclusion, the IURC relied upon a state statute that restricted

\[\text{155} \quad 1994 \text{ Cal. PUC LEXIS 379 at *13.} \]
the scope of includable property to property used in the performance or furnishing of service. A prior decision of the Indiana Supreme Court had interpreted this provision to mean that includable property must be "producing" property or "used and useful" property. On this basis, the IURC concluded that costs recovered in rates must have some relationship to the provision of current utility service, and found that the MGP costs requested by Indiana Gas bore no such relationship. Moreover, because it found that the MGP costs did not relate to the provision of current service, the IURC argued that MGP cost recovery would place Indiana Gas' ratepayers "in the position of insurers" with regard to a liability that any type of business could conceivably incur and for which the utility could have obtained insurance.

Indiana Gas has appealed the IURC decision to the Indiana Court of Appeals, where it is pending.

F. Summary

The clear majority of public utility commissions that have addressed the issue of the rate recovery of MGP costs in contested cases have ruled in favor of full recovery. only one commission has completely denied recovery of net MGP costs. The California settlement presents a possible middle ground between the jurisdictions granting full recovery and those granting partial recovery of net MGP costs.

CONCLUSION

Although the caselaw is still evolving, utilities have generally been successful in their efforts to recover MGP costs through insurance and rates.