IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SIX

EMPLOYERS INSURANCE OF WAUSAU,

Plaintiff, Respondent, and Cross-Appellant,

v.

NEAL FEAY COMPANY,

Defendant, Appellant and Cross-Respondent..

2d Civil No. B196754
(Super. Ct. No. 1164971)
(Santa Barbara County)

Neal Feay Company (Neal Feay) appeals from the judgment, entered after a court trial, declaring that insurance policies it purchased from Employers Insurance of Wausau (Wausau) provide no coverage for, and create no duty to defend Neal Feay in administrative proceedings initiated by the California Regional Water Quality Control Board (RWQCB) to address soil and groundwater contamination at Neal Feay's metal anodizing facility in Goleta. The trial court made the same findings with respect to a lawsuit Neal Feay filed against neighboring landowners for contribution and other damages, and their cross-complaints against it. Neal Feay contends the declaratory relief action should have been stayed pending resolution of both the administrative proceeding and the third party litigation, that the trial court erred when it found Wausau had no duty to defend or indemnify it in either proceeding, and that the trial court erred when it found Wausau did not breach the

policies or act in bad faith. Wausau cross-appeals, contending it is entitled to recover certain defense costs already paid to Neal Feay. We affirm the judgment in its entirety.

Facts

Neal Feay is a metal anodizing business that designs, fabricates and finishes metal parts for audio equipment and other electronic instruments. It has operated from the same facility in Goleta since 1958. The facility is located in an industrial area, near manufacturing plants that are, or have been operated by Applied Magnetics, Inc., Raytheon Co. and EG&G Energy Measurements, Inc., among others. Neal Feay's current president, Neal Rasumussen, is the son of its founder. He has worked at the facility since he was a child.

The Insurance Policies

Wausau issued primary general liability insurance policies to Neal Feay for the period between January 1, 1979 and January 1, 1982. Between January 1981 and January 1982, it also issued an umbrella policy to Neal Feay.

Each primary policy states: "The company [Wausau] will pay on behalf of the insured [Neal Feay] all sums which the insured [Nealy Feay] shall become legally obligated to pay as damages because of [¶] Coverage A. bodily injury or [¶] Coverage B. property damages [¶] to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured [Nealy Feay] seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent and may make such investigation and settlement of any claim or suit as it deems expedient. . . ." Wausau also agreed to pay "reasonable expenses incurred by the insured at the company's request in assisting the company in the investigation or defense of any claim or suit." (Fns. Omitted.)

The umbrella policy states: "It is agreed that with respect to any claim or suit seeking damages by reason of an occurrence to which this policy applies or would apply except for the amount of the retained limit, and for which no defense coverage

for such occurrence is provided by underlying insurance or by any other valid and collectible insurance available to the insured, the company [Wausau] will: [¶] (A) defend any such claim or suit against the insured [Nealy Feay] alleging such damages and seeking recovery on account thereof, even if such suit is groundless, false or fraudulent; but the company [Wausau] may make such investigation, negotiation and settlement of any such claim or suit as it deems expedient . . . . [.] [¶] (D) reimburse the insured [Nealy Feay] for all reasonable expenses, other than loss of earnings, incurred at the company's request." (Fn. Omitted.) Wausau also agreed to pay all sums in excess of the retained limit which appellant became "legally obligated to pay, or with the consent of the company [Wausau] agrees to pay, as damages because of Property Damage." (Fn. Omitted.)

Both the primary and the umbrella policies provide coverage for damages "caused by an occurrence" or "by reason of any occurrence to which this policy applies[.]" They define an occurrence as "an accident, including injurious exposure to conditions, which results in . . . property damage neither expected or intended from the standpoint of the insured."

All of the policies contain a pollution exclusion which precludes coverage for "personal 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 the 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."

May 2002 Incident

In May 2002, Neal Feay's employees emptied approximately 400 gallons of industrial wastewater contaminated with hexavalent chromium into the Goleta sewer system. A tree root blocked the sewer line, causing contaminated wastewater to spill out of a manhole and onto a property adjacent to appellant's facility. Neal Feay hired a contractor to clear the sewer line but did not report the incident to the Goleta

Sanitary District. It was instead reported by the contractor. The Santa Barbara County Fire Department responded to the incident. It directed appellant to perform an environmental site assessment and soils tests in the affected area. Neal Feay removed about 15 tons of impacted soil. In December 2002, the Fire Department referred issues relating to groundwater contamination to the RWQCB for investigation. It later determined that no further action was required to address soil contamination at the facility.

Criminal Proceedings

As a result of the May 2002 incident, the United States Attorney for the Central District of California initiated criminal proceedings against Neal Feay, for violations of the federal Clean Water Act. (33 U.S.C.A. §§ 1251, et seq.) In October 2003, Neal Feay pleaded guilty to the misdemeanor offense of negligently discharging contaminated wastewater into the sewer system. (33 U.S.C.A. §§ 1317, 1319, subd. (c)(1)(A).) Neal Feay also pleaded guilty to the felony offense of failing to immediately report the discharge to the Goleta Sanitary District. (33 U.S.C.A. §§ 1317, 1319, subd. (c)(2)(A).) It paid fines totaling $75,000 and agreed to make restitution to the fire department for its response costs.

The RWQCB Proceeding

In January 2003, following the Fire Department's referral, the RWQCB notified Neal Feay of its determination that groundwater at the facility was contaminated with various hazardous substances, including the industrial solvent trichloroethene (TCE), chromium, beryllium, lead, and thallium. It designated Neal Feay a "responsible party" for the contamination and directed Neal Feay to provide it with a work-plan for investigating the groundwater contamination, including a plan to monitor nearby drinking water wells. Neal Feay was also directed to provide documents and other information concerning its past and present use and storage of hazardous materials at the facility. In October 2003, the RWQCB directed Neal Feay to submit groundwater monitoring reports at six-month intervals.

The RWQCB notified Neal Feay in January 2006 that its investigation into the source of certain contaminants was inconclusive. It directed Neal Feay to perform additional, more detailed soil and groundwater tests and to include the results of those tests in future monitoring reports. Appellant has complied with these orders. The RWQCB has not filed a lawsuit against Neal Feay, ordered the remediation of any property nor has it levied any fines or penalties against Neal Feay.

The Insurance Claims

Neal Feay tendered defense of the RWQCB proceeding to Wausau in November 2003. Wausau requested detailed information from Neal Feay concerning Neal Feay's operations, use of hazardous materials, and the coverage available to it from other insurers. In January 2004, Wausau agreed to reimburse Neal Feay for "reasonable costs incurred in furtherance of [Wausau's] claims investigation." Wausau also declined to defend appellant in the RWQCB proceeding on the ground that its policies required Wausau to defend "suits," rather than "claims." Its letter did not reference the umbrella policy.

Through counsel, Neal Feay provided written responses to Wausau's investigative requests in March 2004. Its letter included an invoice for over $11,000 in attorney fees and $1,300 in other expenses incurred to develop the responses. Wausau eventually reimbursed appellant for some expenses and about $4000 in attorney fees. After reviewing Neal Feay's responses, Wausau again declined the defense of the RWQCB proceeding. Neal Feay responded by noting that the umbrella policy included a duty to defend against both a "claim" and a "suit." Wausau did not change its position.

Appellant provided Wausau with six additional boxes of documents responsive to its request for information. About two weeks later, on May 13, 2004, it sued Wausau for breach of contract, bad faith and a declaratory judgment that Wausau had a duty to defend Neal Feay in the RWQCB proceeding. In June, Wausau agreed to defend appellant under the umbrella policy, reserving its right to seek

reimbursement of defense costs. Appellant dismissed the coverage action without prejudice.

Third Party Lawsuit

In early May 2004, before Wausau accepted the defense, Neal Feay served Notices of Endangerment on nine "potentially responsible parties," notifying them, as required by federal law, that appellant intended to file an action against them alleging their liability for the contamination. (42 U.S.C.A. § 6972, subd. (b)(2)(A).) Six weeks later, Neal Feay's counsel informed Wausau that it had served the notices. In the same letter, counsel "confirmed" an earlier telephone conversation in which, he claimed, Wausau's claims analyst had "supported the commencement of litigation against other potentially responsible parties as part of [appellant's] defense[]" in the RWQCB proceeding. Wausau paid costs and attorneys fees associated with serving the notices.

In August 2004, Neal Feay filed a complaint against these third parties, alleging that their past and present commercial activities on adjoining land contributed to the groundwater and soil contamination at issue in the RWQCB proceeding. (*Neal Feay Co. v. Applied Magnetics Corp., et al.*, Santa Barbara County Superior Court Case No. 01159078.) On the same day, appellant provided a copy of the complaint to Wausau, notifying it that the lawsuit was part of appellant's defense in the RWQCB proceeding because it would force the third parties to share testing and remediation costs. Wausau had no immediate response. A month later, after auditing invoices submitted by appellant, Wausau refused to pay costs associated with the commencement of the third party litigation.

Three of the defendants in the third party lawsuit filed cross-complaints against Neal Feay. Two of these alleged that the contamination resulted primarily from the May 2002 incident. One also alleged that appellant's manufacturing operations "have led to the sudden and accidental, negligent or otherwise discharge" of contaminants into the soil and groundwater on Neal Feay's property and the surrounding properties.

Neal Feay tendered defense of the cross-complaints to Wausau. Wausau accepted the defense under the primary policies, subject to a reservation of rights. At the same time, Wausau entered into an agreement to share defense costs with appellant's other insurers.

The third party lawsuit, which is pending before a different trial court judge, was stayed by that judge. The judge reasoned that "[a]waiting the completion of the [RWQCB's] investigation and determinations regarding a remedial plan, if any, will enhance the court decision-making and efficiency by allowing the court to take advantage of the Board's expertise." The stay remains in place. At a hearing in August 2005, the trial court noted it saw no reason to move forward with extensive discovery in the matter when soils testing had not been completed and the RWQCB had not ordered appellant to do any cleanup work.

Wausau's Declaratory Relief Action

Wausau filed this declaratory relief action against Neal Feay in December 2004. Its operative second amended complaint seeks declarations that it owes no duty, under the primary or the umbrella polices, to defend Neal Feay in the RWQCB proceeding, the third party lawsuit or the criminal proceeding. Wausau further seeks declarations that its primary and umbrella policies provide, "no coverage with respect to past and/or future liability incurred by [appellant] arising out of the environmental contamination at issue" in any of those proceedings. Finally, Wausau seeks reimbursement of the defense costs it has already paid.

Neal Feay's cross-complaint seeks declarations that Wausau has a duty to defend it in the RWQCB proceeding and against the third party cross-complaints. Neal Feay seeks payment of the defense costs that Wausau declined to pay and damages for breach of contract and bad faith.

The trial court denied appellant's motion to stay the declaratory relief action pending resolution of the third party lawsuit. Appellant contended that proving the facts necessary to establish a potential for coverage – e.g., that a sudden and accidental release of contaminants occurred at appellant's facility during the policy

periods – would prejudice its position in the third party lawsuit. The trial court issued a protective order, sealed parts of the record and closed the courtroom to the public during portions of the nonjury trial. It also bifurcated the trial, deciding the duty to defend and coverage issues in the first phase and damages in the second.

The Statement of Decision and Declaratory Judgment

After a seven-day non-jury trial, the trial court issued a detailed, publically available statement of decision and judgment.[1] It identified several releases of pollutants at appellant's facility, in addition to the 2002 incident that prompted the RWQCB proceeding. In 1986, one of appellant's employees emptied a partially filled five-gallon drum containing TCE onto bare ground at the facility. During a 1971 earthquake, less than 30 gallons of chemicals splashed out of their holding tanks onto interior concrete floors and were cleaned up within a few hours. Spills may also have occurred during a 1975 fire and a 1978 earthquake, although Neal Feay's president could not recall any spills associated with either event. Sometime between 1958 and 1971, about five gallons of TCE spilled on to asphalt outdoors while a barrel was being off-loaded from a delivery truck. The spill was cleaned up within 10 minutes.

Neal Feay's expert opined that, over the years, small quantities of chemicals may also have spilled as they were transferred from one part of the facility to another. There was no direct evidence that any of these spills ever actually occurred, nor was the expert witness able to identify the chemicals that may have been spilled or the location or quantity of any spill. Wausau's expert opined that, except for the 1986 and 2002 incidents, the spills described by Neal Feay and its expert were too small, too infrequent, and too quickly cleaned up to cause appreciable property damage. Appellant's expert disagreed. In his opinion, it was possible that chemicals

[1] We also issued an order permitting the parties to file portions of their briefs under seal. Documents filed under seal in the trial court remain confidential in the record on appeal. Our discussion of the facts and proceedings below will include matters that are included in the public portion of the trial court record or have otherwise been made public by the parties or by the trial court. (Cal. Rules of Ct., rules 2.550, 2.551, 8.160.)

released in smaller spills could migrate into the soil and groundwater, either through cracks in the interior floors or through cracks in the sewer lines as they were washed down the lines with water.

The trial court concluded that Wausau's primary policies did not cover, or create a duty to indemnify appellant for costs associated with the RWQCB proceeding, including the cost of monitoring groundwater contamination. Wausau did, however, have a duty under the umbrella policy to defend appellant in the RWQCB proceeding. Its duty to defend arose when the administrative proceeding began and terminated on the last day of trial in the declaratory relief action. The trial court further found that Wausau had no duty, under any of the policies, to defend or indemnify appellant in the third party lawsuit, either with respect to the complaint filed by appellant or with respect to the cross-complaints filed against appellant. According to the trial court, Wausau did not consent to appellant's filing the third party lawsuit. It found that appellant's decision to commence the litigation was "a strategy to be able to insist on a defense of the [RWQCB] claim[,]" and an effort to obtain a stay in the declaratory relief action.

The trial court found that the Wausau policies excluded coverage for " 'property damage arising out of the discharge' of 'toxic chemicals' or other contaminants or pollutants into or upon the land. This exclusion does not apply if such discharge is 'sudden or accidental.' " The policies provided coverage only for property damage that occurred during the policy period. Thus, the trial court imposed on appellant "the burden to prove the investigation commenced by the [RWQCB] in January 2003 sought to recover damages for quantifiable property damage that occurred during the Wausau policy period, as a result of the 'sudden and accidental' release of pollutants." Appellant failed to carry its burden of proof on these issues because, the trial court found, there was no evidence that appellant could "allocate between pollution damages covered (sudden and accidental) and not-covered (not sudden and accidental) . . . [,]" or prove that property damage occurred during the Wausau policy periods.

Finally, the trial court determined that it was not necessary to stay its coverage findings pending resolution of the RWQCB proceeding because the coverage issues did not turn on facts that would be "litigated" in that proceeding. In addition, the trial court found "no evidence . . . that there will ever be an allocation or determination of any liability in the [RWQCB] proceeding. The 'monitoring' required of [appellant] in the [RWQCB] matter could go on for years."

Prior to trial, the court determined that the amount of reasonable attorney's fees to which appellant was entitled, if any, would be decided by arbitration. (Civ. Code, § 2860.) In the trial's second phase, the court awarded appellant defense costs of $25,705.45 plus interest.

Contentions

Neal Feay contends the trial court erred when it: (1) refused to stay the trial in this matter pending completion of the RWQCB proceeding and the third party lawsuit; (2) terminated Wausau's duty to defend appellant in the RWQCB proceeding; (3) found that Wausau had no duty to defend the third party lawsuit or cross-complaints under the primary policies; (4) found that Wausau had no duty to indemnify or cover appellant for remediation costs or damages awarded against it; and (5) found that Wausau did not breach the umbrella policy or act in bad faith by delaying payment of defense costs after appellant tendered its defense in the RWQCB proceeding.

Common to all of these contentions is appellant's claim that the trial court acted prematurely when it made the findings of fact and of law necessary to declare Wausau's duties under the insurance policies. In appellant's view, these findings should not have been made until the RWQCB proceeding and third party lawsuit have been finally resolved. Neal Feay contends it is entitled to a defense from Wausau until all of the coverage questions have been finally adjudicated and there is no longer any evidence showing a potential for coverage under the policies. The declaratory judgment was premature, according to appellant, because the RWQCB has not yet determined whether there is contamination at appellant's facility, and the court

in the third party lawsuit has not yet decided which parties are at fault for the contamination, whether the contamination caused property damage at appellant's facility, whether any property damage arose out of a sudden and accidental release of pollutants, and whether any such release occurred during a Wausau policy period.

Discussion

Stay of Declaratory Relief Action

Neal Feay contends this litigation should have been stayed pending resolution of the RWQCB proceeding and the third party lawsuit because the same facts are at issue in each proceeding and there is a risk of inconsistent factual findings. Neal Feay further contends it was prejudiced by the refusal to grant a stay because the facts it had to prove to show a potential for coverage – i.e., that a sudden and accidental release of pollutants could have occurred – would weaken or contradict its position in the other proceedings. Wausau contends the protective order was adequate to prevent unfair prejudice. We review the order denying the stay for abuse of discretion. There is none. (Code Civ. Proc., § 1061; *State Farm Etc. Ins. Co. v. Superior Court* (1956) 47 Cal.2d 428, 433; *California Ins. Guarantee Assn. v. Superior Court* (1991) 231 Cal.App.3d 1617, 1623-1624.)

As our Supreme Court has explained on many occasions, a liability insurer owes a broad duty to defend its insured against a suit "which *potentially* seeks damages within the coverage of the policy . . . ." (*Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 275.) This duty "is a continuing one, arising on tender of defense and lasting until the underlying lawsuit is concluded [citation], or until it has been shown that there is *no* potential for coverage . . . ." (*Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 295 (*Montrose*).) In an action for declaratory relief on the issue of whether an insurer has a duty to defend, the insured will prevail by proving "the existence of a *potential for coverage*, while the insurer must establish *the absence of any such potential.* In other words, the insured need only show that the underlying claim *may* fall within policy coverage; the insurer must prove it *cannot.*" (*Id.* at p. 300.)

It may be appropriate to stay a declaratory relief action pending resolution of an underlying third party lawsuit, "[t]o eliminate the risk of inconsistent factual determinations that could prejudice the insured . . . ." (*Id.* at p. 301.) However, "when the coverage question is logically unrelated to the issues of consequence in the underlying case, the declaratory relief action may properly proceed to judgment." (*Id.* at p. 302.)

The facts at issue in this declaratory relief action are not identical to those at issue in the third party lawsuit. In the third party lawsuit, the finder of fact will presumably determine the source or sources of the contamination and the parties' relative degrees of fault for any damage it caused. In this case, the trial court made no definitive findings on those issues. Instead, it found there was no substantial evidence of facts creating a potential for coverage under the policies. In other words, there was no substantial evidence that a sudden and accidental release of pollutants potentially occurred during the policy periods causing property damage. Because the two actions involve related, but not identical, inquiries the trial court could have exercised its discretion to stay this trial until judgment is entered in the third party lawsuit. But that lawsuit has itself been stayed pending resolution of the RWQCB proceeding, which has no definitive end date at all. The trial court also had discretion to extricate itself and its calendar from the RWQCB's administrative holding pattern and decide, on the evidence in this record, whether there was any potential for coverage under the Wausau policies.

Nor can we agree that the trial court unfairly forced Neal Feay to choose between proving that it is entitled to a defense on the one hand, and defending its position in the third party lawsuit on the other. Consistent with its protective order, the trial court placed under seal trial exhibits and other documents that might be read to describe potential "sudden and accidental releases" of pollutants at Neal Feay's facility. It also closed the courtroom during testimony regarding those incidents. As a result, Neal Feay was free to provide evidence that incidents actually occurred which create a

potential for coverage under the policy. It was not prejudiced by the trial court's decision to try this action before the third party lawsuit.

Finally, we note that the pending RWQCB proceeding does not entitle Neal Feay to a stay of this action. *Montrose, supra,* 6 Cal. 4th at page 301 discussed staying a declaratory relief action "pending resolution of the third party suit[.]" The RWQCB administrative proceeding is not a "suit" as that term is used in *Montrose.* Our Supreme Court clarified this point in *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, when it held that an administrative agency order requiring the insured to monitor hazardous waste levels and propose a remediation plan did not commence a "lawsuit" or mandate a stay in the insurer's declaratory relief action. (*Id.* at pp. 880-881.)

Potential for Coverage Under Umbrella Policy

The trial court found that Wausau's umbrella policy created a duty to defend Neal Feay in the RWQCB proceeding, but that its duty terminated on the last day of the trial because after that date, there was no longer any potential that the umbrella policy would provide coverage for costs associated with the RWQCB proceeding.[2] According to the trial court, Neal Feay did not carry its burden to prove there was a potential for coverage under the policy because there was no substantial evidence of property damage caused by a sudden and accidental release of contaminants during the Wausau policy period. Neal Feay contends this was error because "a bare 'potential' or 'possibility' of coverage" is enough to trigger the defense duty and because it is premature to require proof that covered property damage occurred during the policy period. (*Montrose, supra,* 6 Cal.4th at p. 300.) We are not persuaded.

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[2] There was no potential for coverage, and thus no duty to defend, under the primary policies because they provide that Wausau will defend a "suit against the insured seeking damages[.]" An insurer's duty to defend a "suit seeking damages" does not "extend to a proceeding conducted before an administrative agency pursuant to an environmental statute." (*Certain Underwriters at Lloyd's of London v. Superior Court* (2001) 24 Cal.4th 945, 951.)

An insurer's duty to defend "continues only so long as the possibility of duty to indemnify remains alive. Once that possibility is extinguished by court order, the duty to defend ceases. Whenever the insurer can demonstrate no possibility of a duty to indemnify, the insurer is entitled to termination of its duty to defend . . . ." (*Liberty Mutual Ins. Co. v. Superior Court* (1997) 58 Cal.App.4th 617, 623.) The insured bears the burden to prove "that the occurrence forming the basis of its claim is within the basic scope of insurance coverage. [Citations.] And, once an insured has made this showing, the burden is on the insurer to prove the claim is specifically excluded." (*Aydin Corp. v. First State Ins. Co.* (1998) 18 Cal.4th 1183, 1188.)

Wausau's umbrella policy excludes coverage for property damage arising out of the release of pollutants into the environment. The exclusion is subject to an exception: it "does not apply if such . . . release . . . is sudden and accidental." Where a pollution exclusion is subject to an exception for " 'sudden and accidental' " events, the "exception is properly construed as a coverage provision when allocating the burden of proof." (*Aydin Corp.*, *supra*, 18 Cal.4th at p. 1191.) As a consequence, the insured bears the burden to prove that the exception applies. (*Id.* at p. 1194; *Montrose, supra*, 6 Cal.4th at p. 295.) The insured also has "the burden of proving a covered act or event was a substantial cause of the injury or property damage for which the insured is liable, and this burden extends to showing the causal act or event was within an exception to a policy exclusion when the insurer has shown the exclusion applicable." (*State of California v. Allstate Ins. Co.* (2009) 45 Cal.4th 1008, 1036 (*Allstate)*.)

Allstate, supra, disapproved two opinions cited by the trial court in the instant matter: *Golden Eagle Refinery Co. v. Associated Internat. Ins. Co.* (2005) 134 Cal.App.4th 187, and *Lockheed Martin Corp. v. Continental Ins. Co.* (2001) 85 Cal.App.4th 1300. In each of those cases, the insured was assigned the burden to prove the exact amount of property damage that had been caused by covered events (e.g., sudden and accidental releases of pollutants) and the amount caused by excluded events (e.g., intentional dumping). Because the insured could not meet that burden,

the courts of appeal held they were not entitled to any coverage at all under their third party liability policies.

In *Allstate, supra*, our Supreme Court expressly rejected this reasoning. Relying on *State Farm Mut. Auto. Ins. Co. v. Partridge* (1973) 10 Cal.3d 94, the Court emphasized that, where a covered event is a substantial factor in causing property damage, "the insurer is obligated to indemnify the policyholder even if other, excluded causes contributed" to the damage. (*Allstate, supra,* 45 Cal.4th at p. 1031.) Thus, the Court held, "if the insured proves that multiple acts or events have concurred in causing a single injury . . . or an indivisible amount of property damage . . . , such that one or more of the covered causes would have rendered the insured liable in tort for the entirety of the damage, the insured's inability to allocate the damages [between covered and excluded causes] does not excuse the insurer from its duty to indemnify." (*Id.* at pp. 1036-1037.) It remains the insured's obligation, however, to prove that a covered event -- a sudden and accidental release of pollutants -- was a substantial factor in causing the property damage for which the insured seeks indemnity. As the Court explained, "Our holding does not extend indemnity to situations where the policy holder can do no more than speculate that some polluting events may have occurred suddenly and accidentally, or where sudden and accidental events have contributed only trivially to the property damage from pollution . . . . Only if the insured can identify particular sudden and accidental events and prove they contributed substantially to causing indivisible property damage for which the insured bore liability is the insurer obliged to indemnify its insured for the entirety of the damage." (*Id.* at p. 1037.)

In the instant case, Neal Feay seeks a defense against the RWQCB's claim that Neal Feay is responsible for groundwater contamination at its facility. To establish its right to a defense under the umbrella policy, Neal Feay has the burden to prove there is a potential that a sudden and accidental release of pollutants from its facility was "a substantial cause" of, or "contributed substantially to" the property damage identified by the RWQCB. (*Allstate, supra*, 45 Cal.4th at pp. 1036, 1037.)

In its final statement of decision, the trial court here found that "Neal Feay did not present evidence demonstrating an ability to allocate between pollution damages covered (sudden and accidental) and not-covered (not sudden and accidental) events among the various insurers. It was Neal Feay's burden at trial to prove that all of the damages it seeks to recover were caused by a covered event of discharge, failing which Neal Feay will recover nothing." Neal Feay contends reversal is required because this analysis was expressly disapproved in *Allstate*. But the trial court also found that, "Neal Feay has not proved that the investigation commenced by the [RWQCB] in January 2003 sought to recover damages for quantifiable property damage that occurred during the Wausau policy period, as a result of the 'sudden and accidental' release of pollutants." This finding is consistent with the holding in *Allstate, supra*, that the insured has the burden to prove a covered event was a substantial cause of the property damage for which it seeks indemnity. (*Allstate, supra,* 45 Cal.4th at pp. 1036-1037.)

Our review of the record, including those portions filed under seal, discloses substantial evidence to support the trial court's findings. Wausau's expert witness testified that the 1986 and 2002 dumping incidents were the only releases at Neal Feay's facility that could have been a substantial cause of property damage. Neal Feay admits these incidents were not "sudden and accidental" within the meaning of the policy. Although Neal Feay identified other occasions on which chemicals might have been released, there was no evidence that any specific release actually occurred during the policy period, or that such a release was sudden and accidental. To the contrary, the releases documented by Neal Feay occurred in or before 1971.

Neal Feay's expert witness also offered the opinion that small amounts of chemicals may have been spilled in connection with events in 1975 and 1978, or in the normal course of business, as they were being transferred from one part of the facility to another, or as parts were placed in or removed from machines and tanks at the facility. The expert could not identify the date or location of any specific spill, quantify the amount of chemical spilled or determine whether any spill in fact caused

property damage or contributed to the contamination discovered after the 2002 incident. Neal Feay's president could not recall any of these accidents having occurred nor was there any documentary evidence of them.

An expert's opinion that it is theoretically possible for an accidental release to have occurred during the policy period is not evidence that such a release actually occurred, or that it contributed more than trivially to groundwater contamination. Because Neal Feay did not "identify particular sudden and accidental events and prove they contributed substantially to causing" the groundwater contamination at issue (*Allstate, supra,* 45 Cal.4th at p. 1037), the trial court properly relied on the testimony of Wausau's expert witness to find there was no potential for coverage under the umbrella policy.

Third Party Cross-Complaints

The trial court found that Wausau did not consent to the filing of Neal Feay's third party lawsuit and that Neal Feay filed the lawsuit as a strategy to force Wausau to provide a defense in the RWQCB proceeding. It concluded that Wausau had no duty to defend or indemnify Neal Feay against the third parties' cross-complaints. Neal Feay contends a duty to defend exists under the primary policies, regardless of whether Wausau consented to the filing of complaint, because the cross-complaints are suits "against the insured seeking damages on account of . . . property damage . . . ." In addition, Neal Feay contends the umbrella policy obligates Wausau to provide a "defense" in the third party lawsuit because that litigation is an integral part of Neal Feay's defense in the RWQCB proceeding. We are not persuaded.

Even if Neal Feay's motives for filing the third party lawsuit are irrelevant, and the cross-complaints qualify as "suits . . . seeking damages" against Neal Feay, its claim for a defense under the primary policies fails for the same reason its claim under the umbrella policy fails. Neal Feay had the burden to prove that the claims alleged against it in the cross-complaints are potentially covered by the Wausau primary policies. (*Aydin Corp., supra,* 18 Cal.4t at p. 1188.) Those policies were in effect from 1979 through 1981. Like the umbrella policy, they exclude coverage for

property damage caused by the release of contaminants or pollutants, except where that property damage arises out of a sudden and accidental release of pollutants. Neal Feay had the burden to prove there was at least a potential that a sudden and accidental release occurred during the primary policy periods and was a substantial cause of the property damage at issue. (*Allstate, supra,* 45 Cal.4th at p. 1036.) For the reasons we have already discussed, Neal Feay failed to carry that burden. At best, it produced evidence showing that a sudden and accidental release potentially occurred in or before 1978 and that non-accidental releases occurred in 1986 and 2002. There was no substantial evidence that a sudden and accidental release potentially occurred between 1979 and 1981. Nor was there any substantial evidence that a sudden and accidental release contributed substantially to the property damage alleged in the cross-complaints. (*Id.* at p. 1037.) As a result, Wausau had no duty to defend Neal Feay against the cross-complaints in the third-party litigation.

We reject Neal Feay's contention that Wausau had a duty under the umbrella policy to pay its fees and costs in the third party lawsuit for the same reason: Neal Feay did not carry its burden to prove that the RWQCB proceeding involves a release that is potentially covered under the umbrella policy. Moreover, Neal Feay failed to prove that initiating the third party lawsuit was "reasonable and necessary" to avoiding or minimizing its liability in the RWQCB proceeding.

Because an insurer's duty is only to provide its insured with a defense, the insurer is not obligated to fund or prosecute actions that seek "affirmative relief" for the insured, such as an award of damages in favor of the insured or a setoff against an adverse judgment. (*Construction Protective Services, Inc. v. TIG Specialty Ins. Co.* (2002) 29 Cal.4th 189, 194-195; *James 3 Corp. v. Truck Ins. Exchange* (2001) 91 Cal.App.4th 1093, 1104.) Thus, the duty to defend does not encompass a duty on the part of the insurer to " 'take affirmative action to recover money' " for its insured. (*James 3 Corp., supra,* 91 Cal.App.4th at p. 1104, quoting *Silva & Hill Constr. Co. v. Employers Mut. Liab. Ins. Co.* (1971) 19 Cal.App.3d 914, 927.) The insurer must, however, "undertake reasonable and necessary efforts to avoid or at least minimize

liability. To that end, it must incur reasonable and necessary costs." (*Aerojet-General Corp. v. Transport Indemnity Co.* (1997) 17 Cal.4th 38, 60.) It is the insured's burden to prove that such expenses are objectively reasonable and necessary to its defense, i.e., that the expenses would be incurred "by a reasonable insured under the same circumstances." (*Id.* at pp. 62, 64.)

We are not persuaded that initiating the third party lawsuit was reasonable and necessary to Neal Feay's defense in the RWQCB proceeding. To date, the RWQCB has not made any finding that Neal Feay alone is responsible for the contamination at issue, nor has it assessed fines or damages or directed Neal Feay to undertake any remedial work. Neal Feay has been directed only to monitor the contamination and submit reports twice a year. Many of the defendants in the third party lawsuit are involved in similar proceedings with the RWQCB and may be required by that agency to participate in any remediation it mandates. Under these circumstances, we are not convinced that a reasonable insured would have sued every adjoining landowner for contribution to a liability that has not yet been assessed. The trial court properly declined to extend Wausau's duty to defend to expenses incurred by Neal Feay in the third party lawsuit.

Duty to Indemnify

Neal Feay contends the trial court erred when it declared that Wausau has no duty to indemnify Neal Feay in the RWQCB proceeding or the third party lawsuit. Appellant contends the trial court's declaratory judgment on this issue is in error for the same reason its declaratory judgment on the duty to defend was in error: because there is a potential for coverage under the policies. We reject the contention for the reasons we have already discussed.

Breach of Contract and Bad Faith

Neal Feay's cross-complaint alleged that Wausau breached its duty to investigate and its duty to defend because it did not immediately acknowledge that the umbrella policy included a duty to defend in administrative proceedings and because it did not accept the defense or reimburse Neal Feay's defense costs for about seven

months after Neal Feay tendered its claim. The trial court found in favor of Wausau, concluding that there was no breach of contract because the costs were eventually paid and "no prejudice to Neal Feay as they had competent and experienced insurance counsel representing them." Neal Feay contends the trial court erred and that Wausau's unreasonable delay was both a breach of contract and bad faith.

The express terms of the umbrella policy and the implied covenant of good faith and fair dealing imposed on Wausau a duty to fully investigate Neal Feay's claim before it declined to provide a defense or to pay other policy benefits. (*Jordan v. Allstate Ins. Co.* (2007) 148 Cal.App.4th 1062, 1073-1074.) An unreasonable denial or delay in the payment of benefits under the policy is a breach of contract and may result in liability for bad faith. "However, where there is a *genuine issue* as to the insurer's liability under the policy for the claim asserted by the insured, there can be no bad faith liability imposed on the insurer for advancing its side of that dispute." (*Chateau Chamberay Homeowners Assoc. v. Associated International Ins. Co.* (2001) 90 Cal.App.4th 335, 347.)

Here, the trial court found Wausau made reasonable efforts to locate and review the umbrella policy and to investigate the factual basis of Neal Feay's claim. Those findings are supported by substantial evidence. Harold Moore, Wausau's claims analyst, described the work he performed and his communications with Neal Feay's counsel. Among other things, Moore testified that he needed to carefully review the claim because it was unusual in that Neal Feay claimed benefits under an umbrella policy even though valuable primary policies had not been exhausted. In addition, Moore had some difficulty obtaining the facts necessary to determine of whether a potentially covered accident had occurred during the umbrella policy period. Neal Feay's counsel identified three potential "accidents," but each one appeared to have occurred outside the policy period and none of them were described in the 15,000 pages of documents Neal Feay had produced. In addition, Moore was not permitted to interview Neal Feay's president, although he did speak to and exchange letters with its counsel. By March 2004, Moore had decided that Wausau should accept the defense

because the umbrella policy included a duty to defend both "suits" and "claims," a term that might encompass the RWQCB proceeding. In early June 2004, Wausau's counsel told Neal Feay that Wausau would accept the defense. Later that month, Wausau gave Neal Feay written confirmation that it had accepted the defense.

The trial court could, and did, credit Moore's testimony and relied upon it to find that Wausau reasonably investigated Neal Feay's claim and, as a result, did not breach the policy or act in bad faith. (*Howard v. Owens Corning* (1999) 72 Cal.App.4th 621, 630-631.) Moore's testimony is substantial evidence supporting the trial court's judgment. (*Johnson v. Pratt & Whitney Canada, Inc.* (1994) 28 Cal.App.4th 613, 622.)

Wausau's Cross-Appeal

In its cross-appeal, Wausau contends the trial court erred when it found that Wausau was equitably estopped from recovering costs it has already paid to defend Neal Feay against the cross-complaints in the third party lawsuit. Wausau contends that the doctrine of equitable estoppel does not apply because it defended Neal Feay under a reservation of rights. Although we too question whether the doctrine of equitable estoppel is properly applied on these facts, we nevertheless affirm because the decision is correct for another reason. (*Rappleyea v. Campbell* (1994) 8 Cal.4th 975, 980-981; *Perlin v. Fountain View Management Inc.* (2008) 163 Cal.App.4th 657, 663-664.)

Our Supreme Court recently clarified the circumstances under which an insurer is entitled to be reimbursed for defense costs paid on a claim that is not potentially covered by its policy: "If any facts stated or fairly inferable in the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer's duty to defend arises and is not extinguished until the until the insurer negates all facts suggesting potential coverage. On the other hand, if, as a matter of law, neither the complaint nor the known extrinsic facts indicate any basis for potential coverage, the duty to defend does not arise in the first instance." (*Scottsdale Ins. Co. v. MV Transportation* (2005) 36 Cal.4th 643, 655.)

The insurer is entitled to reimbursement of defense costs it has paid only where it never had a duty to defend because, as a matter of law, there was never any potential coverage for the insured's claim. (*Id.* at p. 662; *Buss v. Superior Court* (1997) 16 Cal.4th 35, 51.)

As we have already discussed, Neal Feay would only have been entitled to a defense against the cross-complaints if it had proven facts showing there was a potential that the primary policies covered the claims alleged against it. Neal Feay failed to carry its burden to prove those facts and was therefore not entitled to a defense. But the issue was essentially one of fact rather than of law: whether there was any evidence creating a potential that a sudden and accidental release of pollutants caused property damage during the policy periods. Thus, Wausau's duty to defend arose when the cross-complaints were tendered to it. Its duty was extinguished by the trial court's judgment, "but only prospectively and not retroactively . . . ." (*Buss v. Superior Court, supra*, 16 Cal.4th at p. 46.) The trial court did not err when it denied Wausau reimbursement for defense costs already paid in Neal Feay's defense against the cross-complaints.

The judgment is affirmed. Respondent shall recover its costs on appeal.

NOT TO BE PUBLISHED.

YEGAN, J.

We concur:

GILBERT, P.J.

COFFEE, J.

Thomas P. Anderle, Judge

Superior Court County of Santa Barbara

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