TRUMPING POLLUTION EXCLUSIONS

October 2004 - Martin K. Brigham and Daniel Bencivenga

Mark's life hasn't been the same since his accident. A year ago, he was overcome by carbon monoxide produced as a by-product of a machine at his workplace. He lay unconscious for several minutes before he was discovered by a coworker. Though Mark survived the accident, he sustained permanent brain damage.

After a month of hospitalization and regular after care, Mark still is unable to return to work. His skills have diminished. His memory falters. He has persistent headaches. He cannot concentrate for any length of time. These conditions are not likely to improve.

Mark's case seems like a straightforward products liability action. The machine that injured him had been involved in a number of similar accidents. The manufacturer, a small Texas company, clearly should have foreseen the potential for Mark's injury. Though the manufacturer is financially strapped, operating at a loss for the past several years, it maintains a $1million general liability policy that covers bodily injury stemming from the company's products. The manufacturer also has excess liability coverage of $5 million.

Luckily for Mark, a 24-year-old man who is relying on this case to provide financial stability for his uncertain future, this manufacturer had the foresight to purchase adequate insurance coverage for its products.

OR DID IT?

Mark's case and others like it are increasingly the subjects of insurance coverage disputes that policyholders lose -- disputes that center on the meaning and scope of policy pollution exclusions. One of the most hotly litigated issues in insurance law, the pollution exclusion debate has recently expanded from the traditional hazardous waste cleanup claims to include a wide range of products liability and personal injury claims. Accidents stemming from exposure to carbon monoxide, lead paint, asbestos, and a variety of other toxins have been the subjects of coverage disputes in nearly every jurisdiction.

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Increasingly, insurers are able to sidestep coverage by characterizing these tragedies as pollution events. This characterization puts them under policy exclusions that historically have applied to longterm environmental impairment.

The absence of liability coverage in a toxic tort scenario can be devastating for plaintiffs and policyholders alike. Plaintiff attorneys who typically do not fight these coverage battles don't need to know the esoterica of insurance law but should know how these fights play out so they can properly advise clients. For policyholders' attorneys, the lessons learned in 20 years of traditional environmental coverage disputes should not be ignored. These are battles that can be won when efforts are focused in the right direction.

In tort cases, pollution exclusions can be triggered in a variety of fact patterns. For example, a child ingests lead paint from a peeling wall and suffers from lead poisoning; a paint stripper emits methylene chloride fumes that overcome its user; or, as in Mark's case, a machine emits carbon monoxide, injuring a worker. All of these chemical toxins can be and have been characterized as "pollutants" within the meaning of pollution exclusions in commercial general liability (CCL) policies, affording insurers an avenue to deny coverage.

The increasingly broad application of pollution exclusions to toxic torts represents something of a windfall for insurers, who created the exclusions in the early 1970s to limit liability coverage stemming from "traditional" environmental pollution.[1] In an exhaustive discussion of the history and purpose of pollution exclusions, the New Jersey Supreme Court explained that insurers devised them to avoid the financial hit for the cleanup costs associated with claims arising from the gradual discharge of pollutants -- claims that typically were covered by the occurrence-based general liability policies of the 1960's.[2]

In 1973, insurers gained regulatory approval to incorporate pollution exclusions into their standard form. These initial exclusions preempted coverage for pollution claims unless the subject discharge was "sudden and accidental." As insurers found out the hard way, this exclusion was not a solid bar against environmental pollution claims.

Over the past three decades, few insurance issues have been litigated more frequently and with more divergent results than the meaning of "sudden and accidental" in the context of a gradual pollution claim. By and large, courts come down in own of two camps. On the insurer side, courts find the term "sudden" to mean instantaneous or abrupt. Consequently, claims for gradual discharge of pollutants are excluded. On the policyholder side, courts either hold the phrase to be ambiguous, construing it against the insurer, or they find "sudden" to mean unforeseen or unexpected, divorcing it from any temporal connotation.[3]

ABSOLUTE POLLUTION EXCLUSIONS

In 1986, insurers acted to squelch the debate by gaining regulatory approval for "absolute pollution exclusions." Although these new exclusions couldn't shut out claims for gradual pollution events that began before 1986, which are analyzed in light of the policies in effect at the time of the discharge, the absolute pollution exclusion was effective to foreclose post-1986 pollution claims. In these new exclusions, the phrase "sudden and accidental" was eliminated. In its place was language that clearly excluded both instantaneous and gradual pollution events.

Specifically, the exclusion preempted coverage for any injury or property damage stemming from "discharge, dispersal, seepage, migration, release, or escape of pollutants."[4] Pollutants were described to include "any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste. Waste includes materials to be recycled, reconditioned, or reclaimed."[5]

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Armed with broad language of the new absolute pollution exclusions, insurers saw a way to exclude coverage not only for traditional environmental pollution claims but also for toxic torts. In the late 1980s and through the 1990s, the war of words surrounding pollution exclusions shifted its focus from the meaning of "sudden and accidental" to the meaning of "discharge," "dispersal," "release," "contaminant," "irritant," and "pollutant" -- the phraseology of exclusion that has been used by insurers to pull in toxic torts.

As in the traditional environmental coverage disputes, courts have been all over the map in the way they interpret the language of the absolute pollution exclusions. Some courts read broadly the laundry list of potential toxins in the definition of "pollutant" to exclude coverage for toxic tort and products liability claims.[6] Other courts hold that the exclusion applies only to classic claims of environmental impairment like those arising from groundwater contamination, smokestack pollution, or oil spills.[7]

Likewise, some courts have found the language in the exclusion to be ambiguous or overly broad and construe it against the insurer.[8] Others have found the language to be perfectly clear in its preemption of coverage for toxic torts.[9] Indeed, a survey of court opinions on the meaning and application of pollution exclusions in the context of toxic torts can yield a textual interpretation to suit any taste.[10]

REASONABLE EXPECTATIONS

As made apparent by the differences of judicial opinion on the meaning of policy language, policyholders always put themselves in a risky position when they rely exclusively on policy text when asserting their claims. In toxic tort cases, coverage success often lies not in the language of the contract but in the "reasonable expectations" of the policyholder -- expectations formed not simply by policy language but by an amalgam of language, past dealings, insurer promises, and a commonsense understanding of the purpose of liability insurance.

In traditional environmental coverage cases, policyholders have met with success in using the regulatory history of "sudden and accidental" pollution exclusions to show that insurers created an expectation in both regulators and policyholders that these exclusions did not preempt coverage for gradual environmental pollution.[11] In these cases, courts have held in favor of policyholders, finding that their expectations either trump unambiguous policy language or clarifying ambiguous language in favor of the insured.

Likewise in toxic tort cases, courts have shown a willingness to go outside the language of the policy to examine the policyholder's reasonable expectations as to the breadth of its coverage. This is particularly so in cases where an insurer seeks to avoid CGL coverage for pollution events that result from the policyholder's primary business activities. A recent case out of the eastern district of Pennsylvania illustrates the point.

In Reliance Insurance Co. v. VE Corp., the insurer brought a declaratory judgment action to determine its coverage obligations under a "total pollution exclusion," a variant on the absolute pollution exclusion. In the underlying products liability action, the plaintiff claimed he was overcome by carbon monoxide emitted by a VE Vaporator, a direct-fired steam generator used in the concrete-curing industry.

The district court initially granted summary judgment to Reliance, finding that the exclusion preempted coverage for carbon monoxide injury. The court further held that because VE was a sophisticated insured -- represented both by counsel and by an insurance broker -- it was not entitled to rely on the "reasonable expectations" doctrine.

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On appeal, the Third Circuit Court of Appeals agreed that the policy language excluded the carbon monoxide claim.[12] However, the circuit court found that VE's reasonable expectations could trump the express language of the pollution exclusion, notwithstanding VE's status as a sophisticated insured.

As the court stated, under Pennsylvania law, "even the most clearly written exclusion will not bind the insured where the insurer or its agent has created in the insured a reasonable expectation of coverage." The circuit court remanded the case to determine whether the pollution exclusion ran counter to VE's reasonable expectations.

On remand, the district court looked away from the words of the policy and toward the conduct of the insurer and policyholder in the insurance transaction. The case centered on the application of two CGL policies – the first issued by Reliance to VE in May 1991, when Reliance was attempting to woo the VE account; the second, a renewal of the first, issued by Reliance in May 1992. The underlying accident occurred in February 1993, during the term of the renewal policy.

With the original policy, Reliance provided liability coverage to VE for bodily injury claims stemming from the Vaporator -- a machine that emitted carbon monoxide as an expected by-product of its operation. Reliance underwrote this policy based on detailed information about the Vaporator that had been provided by VE's insurance broker.[13]

Both VE's president and its insurance broker testified that when VE procured the original policy from Reliance, the company desired and expected the policy to provide products liability coverage for the Vaporator, including coverage for bodily injury stemming from emission of carbon monoxide.[14]

Although the expectations of both VE and the broker remained the same with respect to the renewal policy, Reliance unilaterally slipped a more restrictive total pollution exclusion into the 1992 renewal -- one that clearly barred coverage for off-site pollution accidents, including the kind that was the subject of the claim. At no time during negotiations for the renewal did Reliance notify VE or its broker of this dramatic change. Although the policy became effective in May 1992, and the premium schedule began, the renewal policy was not delivered to the broker until August. It was delivered to the company in November.[15]

When the policy was delivered, neither the broker nor VE discovered the coverage shift. The underwriter on the policy testified that had VE detected the change and requested that the policy be rewritten to eliminate the new exclusion, Reliance would not have done so. Instead it would have canceled the policy and sent VE to an ancillary market to obtain coverage.[16]

The court found that VE's expectations for coverage -- created by the original policy, by VE's desire for unrestricted products liability coverage, by Reliance's awareness that VE's product emitted a pollutant, and by Reliance's failure to notify VE of the total pollution exclusion and to explain it -- overrode the unambiguous language of the exclusion. VE's "reasonable expectations" controlled the coverage issue.

Though the facts of Reliance are specific, the case provides a useful template for attacking the coverage issue in many toxic tort and products liability cases. When a policyholder buys CGL coverage for its business activities or products, it has an objective desire and expectation that injuries stemming from those activities or products will be covered. As VE"s president said, she expected coverage for "all the potential things that could have happened that would have resulted from the use or presence of the equipment…"[17]

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Further, the policyholder has a reasonable expectation that an insurer will enter its coverage obligations with its eyes open to the business activities of the policyholder. In virtually every underwriting scenario, an insurer will research a business before agreeing to write coverage.

In toxic tort cases, the policyholder can always bring the weight of common sense to a "reasonable expectations" argument. Why would the insured buy products coverage that didn't cover its products? Why would the insured buy premises coverage if the prime activities conducted on the premises remained uncovered?

CASE LAW

Courts have proven unsympathetic to the notion that insurers will sell and policyholders will buy CGL coverage that serves no purpose. In a much-cited case from a North Carolina appellate court, an insurer sought to avoid coverage under a pollution exclusion when fumes from a Perdue chicken plant contaminated an adjacent chicken refrigeration unit, rendering the chickens unsalable.[18] As the court remarked,

Tufco is in the business of installing industrial flooring, and Tufco purchased a commercial liability policy to protect it from liabilities arising from the very type of activity at issue here. This work was no secret… To allow [the insurer] to deny coverage for claims arising out of Tufco's central business activity would render the policy virtually useless to Tufco.[19]

Other courts have looked at policyholders' reasonable expectations with respect to the meaning of pollution exclusions in the context of standard business activity. The Seventh Circuit, for example, has explained that pollution exclusions do not apply to

everyday activities gone slightly, but not surprisingly, awry. There is nothing unusual about paint peeling off of a wall, asbestos particles escaping during the installation or removal of insulation, or paint drifting off the mark during a spray-painting job. A reasonable policyholder… would not characterize such routine incidents as pollution.[20]

Because the regulatory and drafting history of the absolute pollution exclusion is not as detailed as that for its predecessor, the "sudden and accidental" exclusion, policyholders in toxic tort cases have been less successful at generating reasonable expectations arguments based on insurer representations to state regulators or to the insurance-buying community. Some courts, though, have reached back to the regulatory history of the "sudden and accidental" exclusion -- reasoning that the absolute pollution exclusion is a variation on the same theme -- to limit the application of absolute pollution exclusions to traditional forms of environmental impairment.[21]

Balancing these cases that look outside the policy language to stop the application of pollution exclusions are those that rely on the plain meaning of the exclusions to bar toxic tort claims. The lead paint cases provide a good example. A number of courts have found lead paint to be a "pollutant" within the meaning of the exclusions, characterizing paint chips or dust variously as "irritants," "contaminants," "toxic chemicals," or simply "waste." The courts note that the presence of dust or chips in or outside a residence constitutes "discharge," "dispersal," or "release," triggering the exclusions.[22]

It's tough to come up with any hard and fast rules in the conflicting coverage decisions on absolute pollution exclusions. A few things are clear. Increasingly, insurers are using the broad language of the exclusions as a mechanism to deny coverage for traditional toxic tort and products liability claims. Although courts have wrung out virtually every word in the exclusion in search of their correct meaning, there is little uniformity in the decisional law as to how the exclusions should apply.

For policyholders, hypertextual contract interpretation is typically not a successful approach to gaining coverage. Rather, policyholders do well to look away from the policy's language and instead focus on their reasonable expectations in the insurance transaction -- expectations formed by their own desires and understanding of the pollution exclusions by the

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Notes:

1 See Jeffrey W. Stempel, Reason and Pollution: Correctly Construing the "Absolute" Exclusion in Context and in Accord with Its Purpose and Party Expectations, 34 TORT & INS. L.J.1 (1998); Melody A. Hamel, The 1970 Pollution Exclusion in Comprehensive General Liability Policies: Reasons for Interpretations in Favor of Coverage in 1996 and Beyond, 34 DUQ. L. REV. 1083 (1996); Carl A Salisbury, Pollution Liability Insurance Coverage, The Standard-Form Pollution Exclusion, and the Insurance Industry: A Case Study in Collective Amnesia, 21 ENVTL. L. 357 (1991).

2 Morton Int'l. Inc. v. General Accident Ins. Co., 629 A2d 831, 847-55 (N.J.1993), cert. denied, 512 U.S. 1245 reh'g denied, 512 U.S. 1277 (1994).

3 Id. at 855-70.

4 Insurance Services Office, Inc., CGL Form CG 00 021188 (1988).

5 Id.

6 United States Liab. Ins. Co. v. Bourbeau Painting Contractors, 49 F.3d 786 (1st Cir. 1995) (lead paint is pollutant); Brown v. American Motorists Ins. Co., 930 F. Supp. 207 (E.D. Pa.1996), aff'd, 111 F.3d 125 (3d Cir. 1997) (fumes from waterproofing sealant are pollutants).

7 Stoney Run Co. v. Prudential-LMI Commercial Ins. Co., 47 F.3d 34 (2d Cir. 1995) (exclusion does not bar carbon monoxide claim); Sergeant Constr. Co. v. State Auto Ins., 23 F.3d 1324 (8th Cir. 1994) (exclusion does not bar claim relating to muriatic acid).

8 Lefrak v. Chubb Custom Ins., 942 F.Supp. 949 (S.D.N.Y. 996) (ambiguity in definition of pollutant precludes application of exclusion to bar lead paint claim).

9 United States Liab. Ins. Co., 49 F.3d 786; Brown, 930 F. Supp. 207.

10 See William P. Shelley & Richard C. Mason, Application of the Absolute Pollution Exclusion to Toxic Tort Claims: Will Courts Choose Policy Construction or Deconstruction? 33 TORT & INS. L.J. 749 (1998).

11 Morton Int'l, 629 A.2d 831.

12 Reliance Ins. Co. v. Moessner, 121 F.3d 895 (3d Cir.1997).

13 Reliance Ins. Co. v. VE Corp., No. CIV. A. 95-538; 2000 WL 217511, at *5-6 (E.D. Pa. Feb. 10, 2000).

14 Id. at *6.

15 Id.

16 Id. at *7.

17 Id. at *4.

18 West. Am. Ins. Co. v. Tufco Flooring E., Inc., 409 S.E.2d 692, 697 (N.C.Ct.App. 1991), rev. denied, 420 S.E.2d 558 (N.C. 1992).

19 Id. at 697; see also Stempel, supra note l; Sargeant Constr. Co., 23 F.3d 1324, 1327; Island Assoc., Inc. v. Eric Group, Inc., 894 F.Supp. 200 (W.D. Pa. 1995); Minerva Enters., Inc. v. Bituminous Cas. Corp., 851 S.W.2d 403 (Ark. 1993); Bentz v. Mutual Fire, Marine & Inland Ins. Co., 575A.2d 795 (Md. Ct. Spec. App. 1990); A-1 Sandblasting & Steamcleaning Co. v. Baiden, 632 P.2d 1377 (Or. Ct. App. 1981), aff'd, 643 P.2d 1260 (Or.1982

20 Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co., 976 F.2d 1037, 1044 (7th Cir.1992); see also Westchester Fire Ins. Co. v. City of Pittsburgh, Kansas, 768 F.Supp.1463, 1470 (D. Kan. 1991), aff'd sub nom. Pennsylvania Nat'l Mut. Cas. Ins. Co. v. City of Pittsburgh, 987 F.2d 1516 (10th Cir. 1993) ("[T]here is virtually no substance or chemical in existence that would not irritate or damage some person or property. The terms 'irritant' and 'contaminant,' however, cannot be read in isolation, but must be construed as substances generally recognized as polluting the environment.")

21 American States Ins. Co. v. Koloms, 687 N.E.2d 72 (Ill. 1997) (carbon monoxide emissions from furnace are not excluded from coverage); Lefrak Org., Inc. v. Chubb Customs Ins., 942 F.Supp. 949 (S.D.N.Y. 1996) (pollution exclusion does not apply to ingestion of lead paint).

22 United States Liab. Ins. Co., 49 F.3d 786; Saint Leger v. American Fire & Cas. Ins. Co., 870 F.Supp. 641 (E.D. Pa.1994); Kaytes v. Imperial Cas. & Indem. Co., No. 93-1573, 1994 WL 780901 (E.D. Pa. Jan. 6, 1994).

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