Insurance Companies Push the Pollution Exclusion Envelope. Courts Tear it Open.

By Robert D. Chesler, Dennis J. Artese and Dylan LaMorte

Key points:

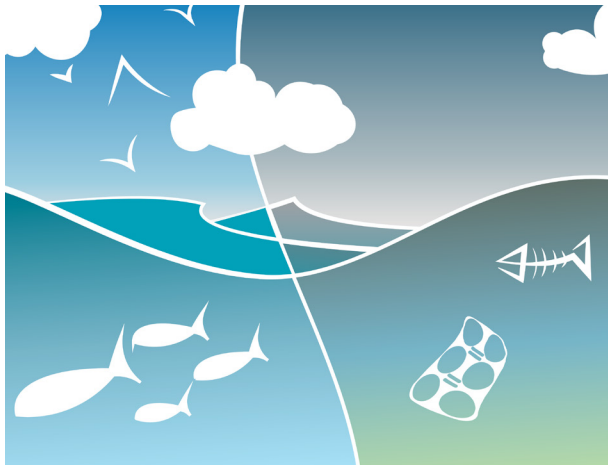
A Texas appeals court recently rejected an insurance company's attempt to invoke the pollution exclusion to deny coverage for damage caused by dust, sand and construction debris set loose by Hurricane Harvey.

Many state courts have ruled that the pollution exclusion in insurance policies applies only to "environmental" pollution and that its application to various smaller-scale discharges is not "virtually boundless."

While policyholders often prevail in disputes over application of the pollution exclusion, they may also consider dedicated environmental coverage.

General liability policies and first party property policies both contain pollution and contamination exclusions. To most policyholders, these exclusions are meant to apply to the release of hazardous substances, i.e., traditional environmental pollution. Insurance companies, however, are trying to push the envelope on the application of these exclusions.

Everest Nat'l Ins. Co. v. Megasand Enterprises, Inc., No. 4:20-CV-1265 at *1 (S.D. Tex. August 5, 2022), involved flooding resulting from Hurricane Harvey. The flooding caused dust, sand and construction debris from the policyholder's site to enter the San Jacinto River. Adjoining landowners sued Megasand, claiming that the dust, sand and debris raised the San Jacinto River, causing it to flood their properties. Everest alleged that the dust, sand and debris were irritants or contaminants, and that the policy's pollution exclusion therefore barred coverage. The pollution exclusion at issue excluded bodily injury or property damage "which would not have occurred in whole or party but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants' at any time." *Id*. at *4. The Policy defined pollutants as "any solid, liquid, gaseous or thermal irritant



or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." Also, per the policy, "waste" was defined as "materials to be recycled, reconditioned, or reclaimed."

Everest sued its own policyholder for a declaration of non-coverage. The policyholder argued in response that the terms of the pollution exclusion were too vague and broad. The court agreed with the policyholder, finding that Everest did not provide any limiting principle, which would prohibit the definition of a word from falling outside the intended scope of its meaning. *Id*. at *7. The court found that silt, sand, sediment and construction material did not qualify as pollutants. As a result, the court held that Everest had to defend Megasand.

The court did not provide an overarching principle that would limit the general liability policy's pollution exclusion solely to "traditional environmental pollution," as have courts in certain states. *See, e.g.*, *Weaver v. Royal Ins. Co. of America*, 674 A.2d 975, 977–78 (1996) (injury caused by ingestion of lead paint dust particles not encompassed by pollution exclusion because exclusion applies only to environmental pollution); *Nautilus Ins. Co. v. Jabar*, 188 F.3d 27, 30 (1st Cir. 1999) (pollution exclusion applied only to environmental pollution, and not to injury from fumes discharged by roofing products used by policyholder in repairing roof); *Beahm v. Pautsch*, 180 Wis. 2d 574 (Ct. App. 1993) (exclusion does not "exclude more than coverage for liability for environmental damage"); *Karroll v. Atomergic Chemetals Corp.*, 194 A.D.2d 715, 600 N.Y.S.2d 101, 102 (2d Dep't 1993) (pollution exclusion can "be reasonably interpreted to apply only to instances of environmental pollution.").

Rather, the court carefully examined definitions of the operative terms irritant and contaminant and found that the dust, sand and construction debris did not qualify as either. The court explained that the operative term irritant was not defined in the policy and thus had to be given the ordinary and everyday meaning of the word used by the general public. Turning to the webster dictionary definition, the court found that irritant as defined, was an "agent by which irritation is produced (a chemical)". *Id.* at *8. The insurance company failed to cite any case where silt, sand, sediment and construction material were defined as irritants. The court also turned to the Webster dictionary definition of the operative term contaminant to find that it meant "to make impure or corrupt by contact or mixture." Similarly, the court found that the insurance company failed to cite any caselaw that would bind the court to hold that the materials in question were contaminants. As a result, the court held that the pollution exclusion at issue did not bar coverage.

As noted, some states limit the effect of the so-called 'absolute' pollution exclusion to "traditional environmental pollution." While this is generally a favorable result for policyholders, debates still arise as to what exactly constitutes "traditional environmental pollution." Other states, though, construe the absolute pollution exclusion far more broadly, to include, for example, toxic releases from a wood sealant or emissions of cement dust, bat guano, pepper spray, gas released by drywall. In such states, courts have failed to limit the wording of the exclusion to apply only to industrial waste and broadly dispersed environmental pollution. *See, e.g., Georgia Farm Bureau Mut. Ins. Co. v. Smith*, 784 S.E.2d 422, 425-26 (2016) (Court applied pollution exclusion as written. The purpose and historical evolution of pollution exclusions were irrelevant in its application of exclusion.)

Property policies also contain broad pollution exclusions. In *Nicholson v. Allstate Ins. Co.*, 979 F. Supp. 2d 1054 (E.D. Cal. 2013) the policyholder sought coverage for a claim arising out of a bat infestation and bat guano under a homeowners insurance policy. The pollution exclusion at issue excluded damages for "[v]apors, fumes, acids, toxic chemicals, toxic gasses, toxic liquids, toxic solids, waste material or other irritants, contaminants or pollutants." *Id.* at 1057.

The insurance company argued for a broad interpretation of the pollution exclusion. The court disagreed and determined that an expansive interpretation of the pollution exclusion would extend it "far beyond its intended scope and lead to some absurd results." *Id.* at 1065.

Policyholders can expect insurance companies to continue to take aggressive positions as to what constitutes excluded "pollutants," "irritants" and "contaminants," particularly in the event of large losses.

Instead, the court interpreted the Policy to exclude substances that a policyholder typically considered a pollutant. The court found that the insurance company failed to satisfy its burden that bat guano equated to "toxic solids, waste material or other irritants, contaminants or pollutants" used in the context of the pollution exclusion. The court explained that typical pollution claims stem from a leakage from a polluted area that causes damage, while here, the damage was caused by bats coming into the structure of the home. The only evidence that the insurance company cited to support its argument that the guano was a pollutant was the policyholder's concession that the guano had a terrible odor. As a result, the court rejected the insurance company's broad interpretation of the pollution exclusion and held that the policyholder's claim was covered under the Policy. *Id.* at 1069.

Similarly, the court in *Mellin v. N. Sec. Ins. Co., Inc.*, 115 A.3d 799, 806 (2015) denied an insurance company's fanciful position that cat urine fell under a pollution exclusion to bar coverage under a homeowners insurance policy. The pollution exclusion bared coverage for the loss caused by the "discharge, dispersal, seepage, migration, release or escape of pollutants." The Policy defined pollutants to mean any "solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

The insurance company argued that the Policy unambiguously defined the term pollutant, and that cat urine qualified as a fume or vapor within the Policy's definition of pollutant. The court disagreed and opined that without limiting the operative terms in the pollution exclusion, it would become "virtually boundless." *Id.* at 552. The court explained that the phrase "any . . . irritant or contaminant . . . [or] vapor" was too broad to meaningfully define the term pollutant, and thus the word was not effectively defined in the Policy. The current definition of pollutant in the Policy was broad enough to include soap, shampoo, rubbing alcohol, and bleach because even those terms were capable of being classified as contaminants. *Id.* at 552. Therefore, the court construed the operative terms in context and as would a reasonable person in the position of the policyholder. The court reasoned that while the policyholder may have reasonably understood the pollution exclusion to preclude coverage for damages resulting from odors emanating from large-scale farms, waste-processing facilities, or other industrial settings, odors created in a private residence by common domestic animals did not equate to a pollutant under the pollution exclusion. *Id.* at 554. Therefore, the court found that the pollution exclusion did not bar coverage under the policyholder's claim.

Insurance companies have even tried to exclude coverage under property policies by arguing that COVID-19, a virus, fell within the definition of a pollutant, even when the Policy did not define pollutant as including viruses. *See, e.g., Urogynecology Specialist of Fla. LLC v. Sentinel Ins. Co.*, No. 6:20-cv-1174, 2020 WL 5939172, at *4 (M.D. Fla. Sept. 24, 2020) ("Denying coverage for losses stemming from COVID-19, however, does not logically align with the grouping of the virus exclusion with other pollutants such that the Policy necessarily anticipated and intended to deny coverage for these.")

Policyholders can expect insurance companies to continue to take aggressive positions as to what constitutes excluded "pollutants," "irritants" and "contaminants," particularly in the event of large losses. While policyholders often have the better of the arguments in such disputes, they may also consider

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dedicated environmental coverage to fill any gaps in their existing programs of liability and property insurance. Normally, environmental coverage provides coverage for loss or damages resulting from unexpected releases of pollutants typically excluded in general liability and property insurance polies. At a minimum, the environmental coverage should cover any bodily injury, property damage, cleanup expenses – required by environmental laws, and defense costs related to underlying claims. These types of environmental policies usually apply to listed locations and are especially important for commercial buildings and habitational risks, such as apartment complexes and hotels.

Every policyholder should examine its operations to determine if it has an environmental exposure, particularly in view of the expansive definitions of "pollutants," "irritants," and "contaminants" being trumpeted by the insurance industry and certain courts. Companies may find that they need to negotiate these provisions or purchase stand-alone environmental coverage in order to protect themselves.

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