

Environmental Law

The Absolute Pollution Exclusion

Limited to traditional environmental catastrophic events

By Ellis I. Medoway and Trevor J. Cooney

Five years ago, the New Jersey Supreme Court held that the “absolute pollution exclusion” found in commercial general liability (CGL) insurance policies may only be invoked to bar coverage when the claim involves “traditional environmental pollution.” In *Nav-Its, Inc. v. Selective Ins. Co.*, 183 N.J. 110 (2005), the Court followed its rationale in *Morton International, Inc. v. General Accident Insurance Co. of America*, 134 N.J. 1 (1993), thereby rejecting the insurance industry’s attempt to broaden the scope of the exclusion beyond its historical limits and in contravention of its regulatory representations. Thus, *Nav-Its* found the exclusion did not bar coverage when the claim involved personal injuries arising from indoor exposure to toxic fumes released during a contractor’s application of paint and floor sealant in connection with an office renovation. Such an event simply did not conjure up what a reasonable insured would consider to be a traditional environmental catastrophe requiring

Medoway and Cooney are members of the insurance practice group of Archer & Greiner in Haddonfield. The firm represented the policyholder in the Nav-Its case. The views and opinions expressed in this article are those of the authors and not necessarily those of the firm or its clients.

government-mandated cleanup.

The question posed after *Nav-Its* is what constitutes “traditional environmental pollution”? Recently, in *Baughman v. United States Liability Insurance Co.*, 662 F. Supp. 2d 386 (D.N.J. 2009), the federal district court offered such guidance, concluding that personal injury resulting from exposure to toxic mercury fumes inside a daycare center does not qualify as “traditional environmental pollution.” This is so even though mercury contamination might have spread beyond the daycare structure, since the underlying lawsuits principally focused on the injuries caused by indoor mercury exposure.

The court’s analysis and ultimate conclusion in *Baughman* that injuries resulting from indoor exposure to toxic substances do not equate with “traditional environmental pollution” and should thus be covered by CGL policies — is entirely consistent with the history and purpose behind the insurance industry’s adoption of the absolute pollution exclusion. That historical perspective forms the basis of the *Nav-Its* decision. Consequently, before discussing *Baughman*, this article will first briefly address the origin of the absolute pollution exclusion.

History/Purpose of Pollution Exclusion

In *Morton*, the Court chronicled the events leading up to the adoption of the insurance industry’s first pollution exclu-

sion, which events were “well-documented and relatively uncontroverted.” Prior to 1966, CGL policies provided coverage for “bodily injury” and “property damage” that was “caused by an accident.” The term “accident” was undefined in these policies, and courts generally interpreted the word “accident” broadly so long as the alleged injury was “unexpected and unintended from the insured’s standpoint.” In 1966, the insurance industry revised its standard form CGL policy, affording coverage based on an “occurrence” rather than an “accident.” This revision to the CGL policy was generally understood to broaden coverage for pollution-related incidents, which included pollution liability arising from gradual and continuous losses.

At the time the “occurrence-based” CGL policy was being adopted, the public was becoming more aware of environmental calamities. Based on the breadth of coverage afforded by the occurrence-based CGL policy, and concerned about the increasing number and substantial costs associated with environmental pollution claims, the insurance industry began drafting and securing regulatory approval for what became known as the standard, or “sudden and accidental” pollution exclusion. The result of those efforts was the adoption of the standard exclusion that, read literally, allowed for coverage only if the “discharge, dispersal, release or escape [of pollutants] is sudden and accidental.”

In seeking approval of the “sudden and accidental” pollution exclusion, however, the insurance industry issued to state regulators an explanatory memorandum

that represented the exclusion would not bar coverage if the pollution-related loss was caused by an accident, that the exclusion merely “clarified” existing coverage. Accordingly, no rate change was sought in connection with the introduction of this exclusion in the early 1970s.

Following its introduction, litigation ensued over the meaning of the words “sudden and accidental,” the primary focus of which was whether the term “sudden” should be provided a temporal meaning so that the exception to the exclusion was only triggered if the pollution discharge occurred abruptly. However, this national debate over the meaning of “sudden and accidental” took a different turn in New Jersey.

Morton instead focused on the regulatory approval process, observing the critical inquiry was whether New Jersey courts should give effect to the literal meaning of the pollution exclusion when its explanatory memorandum was touting that the exclusion merely “clarified” the scope of coverage already afforded by the “occurrence-based” policy. Because *Morton* ultimately concluded that the insurance industry mislead state regulators when seeking approval of the standard form exclusion, it rejected a literal interpretation of the “sudden and accidental” language.

Absolute Exclusion

Around 1985, the insurance industry introduced what was proclaimed to be an “absolute pollution exclusion.” As with the predecessor exclusion, state regulatory filings were necessary in order for the exclusion to be approved. The insurance industry represented to New Jersey regulators that the new exclusion was not all encompassing, that claims involving toxic substances that were nonenvironmental in nature would still be covered. Given this background, the *Nav-Its* Court pronounced it was “confident that the history of the pollution-exclusion clause in its various forms demonstrates that its purpose was to have a broad exclusion for traditional environmentally related damages.”

Nav-Its thus rejected the carrier’s attempt to broaden the scope of the absolute exclusion beyond its intended purpose.

The broader interpretation of the exclusion offered by the insurance industry was criticized by *Nav-Its* as being “overly broad, unfair, and contrary to the objectively reasonable expectations of the New Jersey and other state regulatory authorities that were presented with an opportunity to disapprove the clause.”

Baughman case

In *Baughman*, the court’s task was to determine whether bodily injuries resulting from indoor exposure to toxic mercury fumes fit within what the *Nav-Its* Court considered “traditional environmental pollution.” The court ultimately concluded that indoor exposure to toxic mercury fumes does not qualify as such and, thus, both a defense and indemnity should be afforded the Baughmans.

In December 2005, the Baughmans (husband and wife) purchased an existing daycare center (“Kiddie Kollege”). In late July 2006, the New Jersey Department of Environmental Protection (NJDEP) advised the Baughmans that their daycare center had to shut down due to mercury contamination. The mercury contamination emanated from the earlier business activities conducted by Accutherm, Inc., a thermometer manufacturing company that operated out of the same building Kiddie Kollege was located for a period of 20 years.

In October 2006, several lawsuits were filed against the Baughmans and others, including Acutherm and the NJDEP, on behalf of children who attended Kiddie Kollege, as well as employees of the daycare center. The Baughmans timely notified their CGL carrier, United States Liability Insurance Company (United), but United declined coverage based on the absolute pollution exclusion.

The claims directed against the Baughmans included proposed class actions, strict liability, public nuisance, negligence and battery. All of these causes of action related solely to plaintiffs’ alleged personal injuries caused by exposure to toxic mercury fumes that occurred within the Kiddie Kollege building. There were no claims for environmental cleanup or environmental remediation costs. Plaintiffs sought compensatory damages, super-

vised medical monitoring and other related declaratory relief.

United argued that all of these claims fell within the CGL policy’s absolute pollution exclusion because they involved a “pollutant” and “traditional environmental pollution.” The Baughmans countered that because the underlying claims for mercury exposure occurred “inside Kiddie Kollege,” those claims did not arise from what *Nav-Its* defined as “traditional environmental pollution.” Similar to the injuries resulting from indoor exposure to toxic fumes suffered by the plaintiff physician in *Nav-Its*, here too, the Baughmans argued that plaintiffs’ indoor exposure to toxic mercury fumes simply fails to equate with the catastrophic type of environmental pollution claim the absolute exclusion was specifically designed to address. The court agreed.

The court ultimately concluded that United should provide full coverage to the Baughmans because all of the underlying claims arose solely from indoor exposure to mercury fumes. Thus, exposure to toxic material inside the daycare center was found dispositive for coverage in *Baughman*, as it was in *Nav-Its*, because the nature of indoor exposure negates “contact with discharge, dispersal, seepage, release or escape of ‘pollutants’” into the environment — i.e., land and water as *Nav-Its* requires for there to be traditional environmental pollution.

As *Nav-Its* cautions, when the insurance industry seeks to restrict coverage of certain risks, “particularly those that affect the public interest, such as the risk of damage from pollution, environmental or otherwise,” such restriction of coverage “must be fully and unambiguously disclosed to regulators and the public.” Clearly, that was not done when the insurance industry introduced both the standard and absolute pollution exclusions. What *Nav-Its* and *Baughman* make clear is that the scope of the absolute pollution exclusion is limited to those types of catastrophic pollution events that conjure up in the mind of the reasonable insured what has been termed “traditional environmental pollution.” Exposure to toxic elements inside a building does not satisfy this stricture. ■