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Articles

Nav-Its Follows *Morton's* Legacy: Insurance Industry Held Accountable for Presentations to Regulatory Authorities; Absolute Pollution Exclusion Thus Limited to Traditional Environmental Claims

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I. Introduction

Since its introduction in 1985, the absolute pollution exclusion has generated considerable judicial attention as to its intended exclusionary effect. Policyholders argue that the absolute pollution exclusion in its various forms was designed to address only traditional environmental claims and, thus, should be accorded a narrow interpretation. Insurers counter by arguing that the plain meaning of the exclusion bars coverage for any incident involving a toxic substance and, consequently, should be given a much broader reading. The California Supreme Court recently observed that with respect to state supreme courts that have taken a definitive position on the issue, a majority of those courts have followed the policyholder's argument and given the exclusion a much narrower construction.[1]

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Nav-Its Follows *Morton's* Legacy:

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In *Nav-Its, Inc. v. Selective Insurance Company*,[2] the New Jersey Supreme Court joined the majority approach, concluding that another form of the absolute pollution exclusion did not bar coverage for personal injuries caused by exposure to toxic fumes that emanated from a floor coating/sealant operation performed by the insured contractor. In analyzing this much litigated issue, however, the *Nav-Its* court took somewhat of a different approach by relying principally on its regulatory estoppel decision in *Morton International, Inc. v. General Accident Ins. Co. of America*.[3] In doing so, the *Nav-Its* court has given policyholders another basis to limit the scope of the absolute pollution exclusion to its historical and intended purpose: traditional environmental pollution claims.

This article will first discuss the history and purpose behind the insurance industry's adoption of the absolute pollution exclusion. Next, this article will address the insurance industry's representations and testimony before the New Jersey Department of Insurance when it sought regulatory approval of the exclusion. The article will then briefly discuss how courts have reacted to this historical backdrop in analyzing the intended scope of the exclusion and, finally, this article will discuss the *Nav-Its* decision in particular.

II. History and Purpose of Absolute Pollution Exclusion

In the early 1970s, the insurance industry adopted what is referred to as the standard pollution exclusion. The events leading up to the adoption of that first pollution exclusion "are well-documented and relatively uncontradicted."[4]

Prior to 1966, comprehensive general liability policies ("CGL") provided coverage for bodily injury and property damage "caused by an accident," the term accident being undefined in the standard-form CGL policy.[5] Courts generally interpreted the term "accident" broadly so as to include pollution-related injuries.[6]

In 1966, the insurance industry modified its "accident-based" policy to provide coverage based on an "occurrence." The new CGL policy defined "occurrence" as "an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury or property damage that was neither expected nor intended from the standpoint of the insured."[7] The 1966 revision to the CGL policy was generally understood to actually broaden coverage for pollution related incidents, so as to include pollution liability arising from gradual and continuous losses.[8]

> ***"However, coinciding with the adoption of the 'occurrence-based' CGL policy was the public's growing awareness of environmental calamities during the 1960s."***

However, coinciding with the adoption of the "occurrence-based" CGL policy was the public's growing awareness of environmental calamities during the 1960s. During this period, the well publicized environmental catastrophes of Times Beach, Love Canal and Torrey Canyon came to the forefront of public concern.[9] Due to the broadened coverage afforded by the occurrence-based CGL policy, and foreseeing the potential for a substantial increase in environmental pollution related claims in the wake of these environmental disasters, the insurance industry began the process of drafting the standard pollution exclusion, or what also became known as exclusion "f" of the standard-form CGL policy.[10]

Standard Pollution Exclusion "f"

The standard pollution exclusion provided:

> This insurance does not apply . . .
>
> (f) 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 material 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.*

(emphasis added).

The insurance industry sought state regulatory approval to have exclusion "f" included in CGL policies by, among other things, providing state regulators with a standard explanatory memorandum. That memorandum essentially stated that exclusion "f" would not bar coverage if the pollution related loss was the result of an "accident." Consequently, no rate change was sought with the introduction of the standard pollution exclusion.[11] Exclusion "f" was first introduced in the early 1970s as an endorsement to standard-form CGL policies. By 1973, the standard pollution exclusion was incorporated directly into the body of the policy as exclusion "f."[12]

What followed was more than a decade of litigation over the exact meaning of the words "sudden

and accidental." A major focus of this litigation was whether the term "sudden" should be accorded a temporal meaning, so that the exclusion's exception was only triggered if the pollution discharge occurred abruptly.[13] Contrary to the insurance industry's hopes, many of these cases resulted in policyholders receiving coverage for pollution-related losses. Distressed over these judicial results, and cognizant of the expansion of liability for remediating hazardous waste sites resulting from Congress' adoption in 1980 of the Comprehensive Environmental Response, Compensation and Liability Act, the insurance industry responded with the introduction of a new exclusion, first appearing in 1985, that was dubbed the "absolute pollution exclusion."[14]

Absolute Pollution Exclusion

The absolute pollution exclusion introduced in 1986 in standard-form CGL policies provided:

> This insurance does not apply to . . .
>
> f. (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:
>
> (a) At or from premises you own, rent or occupy;
>
> (b) At or from any site or location used by or for you or others for the handling, storage, disposal, processing or treatment of waste;
>
> (c) Which are at any time transported, handled, stored, treated, disposed of, or processed as waste by or for you or any person or organization for whom you may be legally responsible; or
>
> (d) At or from any site or location on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations:
>
> (i) if the pollutants are brought on or to the site or location in connection with such operations; or
>
> (ii) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants.
>
> (2) Any loss, cost, or expense arising out of any governmental direction or request that you test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.
>
> Pollutants means 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.

The absolute pollution exclusion and its various forms differ from the predecessor exclusion in two important ways. First, the exception for the "sudden and accidental" discharge or release of pollution was eliminated. Second, the requirement that the pollution be discharged "into or upon land, the atmosphere or any water course or body of water" was likewise eliminated.[15]

> ***"No doubt, the primary purpose behind introducing the new 'absolute' exclusion was to ensure that governmental cleanup costs related to environmental pollution would no longer be covered."***

No doubt, the primary purpose behind introducing the new "absolute" exclusion was to ensure that governmental cleanup costs related to environmental pollution would no longer be covered. As the Illinois Supreme Court so aptly observed:

> Our review of the history of the pollution exclusion amply demonstrates that the predominate [*sic*] motivation in drafting an exclusion for pollution-related injuries was the avoidance of the "enormous expense and exposure resulting from the 'explosion' of *environmental* litigation." . . . We would be remiss, therefore, if we were to simply look to the bare words of the exclusion, ignore its *raison d' etre,* and apply it to situations which do not remotely resemble traditional environmental contamination. . . . We think it improper to extend the exclusion beyond that arena.[16]

III. Industry Representations/Testimony Before The New Jersey Regulators

On December 18, 1985, several insurance industry representatives appeared before the New Jersey State Department of Insurance to give testimony on the subject of whether the absolute pollution exclusion should be approved for inclusion in standard-form CGL policies in place of exclusion "f."[17] New Jersey officials indicated the purpose of the hearing was to provide the insurance industry with a forum to explain the need for such an exclusionary change, whether alternatives were considered by the industry and what effect such an exclusion might have on the market.[18] One concern voiced by New Jersey regulators was the impact the new exclusion would have on rates. Based on several insurer filings, it appeared there would be no rate impact as a result of the exclusion's adoption.[19]

The first insurance representative witness to testify was Michael L. Averill, manager of the Commercial Casualty Division of the Insurance Service Office ("ISO").[20] In his prepared statement, Mr. Averill gave a brief summary of the insurance industry's experience providing coverage for pollution events since the 1960s, explaining how CGL policies were revised from an "accident basis" to an "occurrence

basis" in 1966, which latter basis broadened coverage for pollution exposures.[21] He stated environmental disasters in the late 1960s focused the public's attention on environmental issues and, in response, the insurance industry developed exclusion "f" in the early 1970s.[22] However, because of various federal and state environmental legislation that had recently been introduced, such as CERCLA that imposed joint and several liability, and because the insurance industry had a "complete lack of faith" in the judicial system based on court rulings regarding exclusion "f," he further testified that it had become necessary to modify the pollution exclusion and that is why the "absolute" form of that exclusion was being submitted for approval.[23]

According to Mr. Averill, this new pollution exclusion was drafted to clarify that "clean up costs" — associated with the remediation and containment of environmental pollution — were specifically excluded from coverage.[24] Nevertheless, Mr. Averill emphasized that the new exclusion,

> is not an absolute exclusion. It does not apply, as it is written, to some off-premises operations, and it does not apply, as written, to products liability exposures.[25]

Also testifying at the hearing was Robert J. Sullivan, Vice President of Government Affairs for Crum & Forster at their New Jersey office. Mr. Sullivan was similarly critical of judicial decisions interpreting exclusion "f," focusing much of his dissatisfaction on the New Jersey judiciary. In short, he emphasized that because the insurance industry could "no longer trust the New Jersey Judiciary," it had become necessary to adopt a more absolute or "total" pollution exclusion.[26] Nonetheless, Mr. Sullivan echoed Mr. Averill's comments, that this new exclusion was not intended to be so "total" or "absolute."

> I think it's important to emphasize a point that was made earlier and that is these are not total, absolute pollution exclusions. It does have significant coverage for completed operations and product liability in certain off-site discharges.
>
> While that may seem narrow, when you talk to a manufacturer [of] an underground storage tank, it provides, even with the exclusion, significant pollution coverages provided to that manufacturer for pollution liability coverages arising out of product liability claim for his underground storage tank. So, there is still a considerable amount, admittedly for certain classes of risk, of pollution liability coverage, even under the almost total pollution exclusion that the current forms provide.[27]

It is clear from these proceedings that the New Jersey regulators were concerned with the breadth and scope of the new pollution exclusion being proffered and, thus, sought assurance from the carrier representatives that the absolute pollution exclusion was intended to address only traditional environmental pollution claims.[28] In the context of that inquiry, Mr. Sullivan responded: "[O]bviously, the pollutant risk, the exclusion is tied to the pollutants and to waste, discharge, on-site premises of pollutants or waste."[29]

"It is clear from these proceedings that the New Jersey regulators were concerned with the breadth and scope of the new pollution exclusion being proffered and, thus, sought assurance from the carrier representatives that the absolute pollution exclusion was intended to address only traditional environmental pollution claims."

That official position of the insurance industry was similarly communicated through a 1985 ISO "explanatory memorandum" that discussed the intended scope of the absolute pollution exclusion. The memorandum stated that the exclusion "does not apply to damages arising out of products or completed operations nor to certain off-premises discharges of pollutants. Clean-up costs are specifically excluded as a clarification of current intent."[30]

In short, there was no indication from the insurance industry witnesses that appeared before New Jersey regulators, nor from other official industry pronouncements, that this new pollution exclusion was intended to be read more broadly than necessary to address the industry's primary concern — traditional environmental pollution claims.[31]

IV. Courts Construe Absolute Pollution Exclusion

After its adoption in the mid-1980s, courts did not have difficulty in applying the absolute pollution exclusion to bar coverage in the strict context of a traditional environmental claim. For that was its obvious intended application.[32] The more difficult question that confronted courts was how far should the exclusion be read.

As noted at the outset of this article, policyholders have argued that the absolute pollution exclusion should be narrowly construed and applied only to traditional environmental pollution claims. Many courts have so held, and the growing trend has been for courts to limit the contours of the absolute pollution exclusion to such circumstances.[33] In finding coverage for non-environmental losses, even though toxic substances may be involved, several state supreme courts have found the policyholder's

argument regarding the history and purpose behind the exclusion to be compelling.[34]

Carriers, on the other hand, have insisted that the plain meaning of the absolute pollution exclusion is unambiguous and clear on its face, that it must be read broadly and that resort to extrinsic evidence — such as the drafting and regulatory history behind the exclusion's genesis — is inappropriate and irrelevant. The insurance industry has been successful in making this argument, although this position is more the minority view and is inconsistent with a growing trend that has recognized the exclusion cannot and should not be construed in a vacuum.[35]

> ***"In seeking coverage for non-traditional environmental pollution claims, policyholders will often raise, in the context of its historical background, the absolute pollution exclusion's regulatory history, i.e., what did the insurance industry represent to regulators when they were seeking state approval of that exclusion?"***

In seeking coverage for non-traditional environmental pollution claims, policyholders will often raise, in the context of its historical background, the absolute pollution exclusion's regulatory history, *i.e.*, what did the insurance industry represent to regulators when they were seeking state approval of that exclusion? Until now, courts have accorded some, but not significant weight to that argument. The New Jersey Supreme Court has changed that perspective in *Nav-Its*, which is discussed in the next section of this article.

V. The *Nav-Its* Decision

The record before the New Jersey Supreme Court in *Nav-Its* was based on the parties' cross-motions for summary judgment. The material facts that framed that motion were relatively simple and straightforward.

Factual Background

The plaintiff-policyholder Nav-Its, Inc. ("Nav-Its") is a construction contractor that specializes in tenant "fit-out" work. This work includes the building of partitions, the laying of concrete, installation of doors and the application of finishes, such as paint, floor sealants and coatings. Nav-Its sought to insure the risks associated with its contractor activities by purchasing commercial general liability insurance from the defendant, Selective Insurance Company of America ("Selective"). In April of 1998, Nav-Its contracted to perform tenant fit-out work in a shopping center in Allentown, Pennsylvania. Nav-Its hired a subcontractor (T.A. Fanikos Painting) who performed painting and floor sealing work on the project from July 27 through August 5, 1998. During that timeframe, Dr. Roy Scalia, a physician who worked in an adjacent office building at the shopping center, alleged that he was exposed to fumes that were released from the painting subcontractor's application of paint and floor sealant. As a result of that exposure, Dr. Scalia suffered from nausea, vomiting, lightheadedness, loss of equilibrium and headaches. He sought medical treatment for those symptoms in September 1998.[36]

In December 2000, Dr. Scalia filed an action against Nav-Its and other parties for personal injuries he sustained from his exposure to fumes while working at his medical office from July 27 through July 31, 1998, and from August 3 through August 5, 1998. The action was filed in Pennsylvania state court.[37] Nav-Its notified Selective of the complaint and requested a defense and indemnification. Relying on the pollution exclusion in its policy, Selective denied coverage. Eventually, Dr. Scalia's case against Nav-Its was resolved through binding arbitration.[38]

Nav-Its brought a declaratory judgment action in New Jersey against Selective, seeking a declaration that Selective was obligated to defend and indemnify it in connection with the underlying personal injury action brought by Dr. Scalia. Early in that litigation, the parties cross-moved for summary judgment. The trial court denied Selective's motion, and granted Nav-Its' cross-motion concluding that Nav-Its had a reasonable expectation that it would be covered for liability arising out of its normal business operations (*i.e.*, painting). Selective moved for reconsideration, which application was denied. The trial court then issued a written opinion, further concluding that Selective's pollution exclusion should be limited to traditional environmental pollution claims.[39]

While the matter was still pending before the trial court, a panel of the New Jersey Superior Court, Appellate Division concluded in another case, *Leo Haus, Inc. v. Selective Ins. Co.*, that Selective's absolute pollution exclusion was clear and unambiguous and, thus, barred coverage for the plaintiffs' injuries in that matter. The Plaintiffs in *Leo Haus* suffered personal injuries from exposure to carbon monoxide in their home, caused by a defective heater, over a one-year period.[40] Based on *Leo Haus*, Selective again moved for reconsideration. The trial court once again denied the application, reiterating that Selective's pollution exclusion should be limited to environmental claims. The trial court also found that the 48-hour indoor exception within Selective's pollution exclusion applied because "Dr. Scalia suffered individual exposures every day he entered his

office, namely that each exposure began and ended in a less than forty-eight hour period."[41]

The matter was eventually appealed and, in an unpublished opinion, the Appellate Division reversed the trial court, finding that Selective's pollution exclusion was unambiguous and clear in terms of it not being limited to the remediation of traditional environmental pollution. Despite that conclusion, the court found that a jury had to decide whether each of Dr. Scalia's appearances at work represented a separate exposure of less than 48 hours. The parties thereafter cross-petitioned for certification and the New Jersey Supreme Court granted both applications.[42]

Selective's Absolute Pollution Exclusion

The Selective CGL policy contained a pollution exclusion endorsement that provided in relevant part:

> [Selective] shall have no obligation under this coverage part:
>
> a. to investigate, settle or defend any claim or suit against any insured alleging actual or threatened injury or damage of any nature or kind of persons or property which:
>
> 1. arises out of the "pollution hazard;" or
>
> 2. would not have occurred but for the "pollution hazard;" or
>
> b. to pay any damages, judgments, settlements, losses, costs or expenses of any kind or nature that may be awarded or incurred by reason of any such claim or suit or any such actual or threatened injury or damage; or
>
> c. for any losses, costs or expenses arising out of any obligation, order, direction or request of or upon any insured or others, including but not limited to any governmental obligation, order, direction or request, to test for, monitor, clean up, remove, contain, treat, detoxify, neutralize, in any way respond to, or assess the effects of "pollutants."

The Selective policy defined "pollutants" as any "solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." Under the Selective policy, "[w]aste includes materials to be recycled, reconditioned or reclaimed." In addition, the Selective policy defined "Pollution Hazard" to mean "an actual exposure or threat of exposure to the corrosive, toxic or other harmful properties of any 'pollutants' arising out of the discharge, dispersal, seepage, migration, release or escape of such 'pollutants.'"[43]

The Selective exclusion also contained an exception for limited periods of exposure indoors. That exception provided the pollution exclusion does not apply to:

> B. Injury or damage arising from the actual discharge or release of any "pollutants" that takes place entirely inside a building or structure if:
>
> 1. the injury or damage is the result of an exposure which takes place entirely within a building or structure; and
>
> 2. the injury or damage results from an actual discharge or release beginning and ending within a single forty-eight (48) hour period; and
>
> 3. the exposure occurs within the same forty-eight (48) hour period referred to in 2. above; and
>
> 4. within thirty (30) days of the actual discharge or release:
>
> a. the company or its agent is notified of the injury or damage in writing; or
>
> b. in the case of "bodily injury," the "bodily injury" is treated by a physician, or death results, and within ten (10) additional days, written notice of such injury or death is received by the company or its agents.
>
> Strict compliance with the time periods stated above is required for coverage to be provided.[44]

Court's Analysis

The court posited that the "central question" before it is "whether we should limit the applicability of the pollution exclusion clause to traditional environmental pollution claims."[45] In analyzing the appropriate construction to be applied to the exclusion, the court noted that its analytical effort was "informed" by its case law and by the decisions in other jurisdictions that had addressed this similar issue. The first case the court turned to by way of instruction was its decision in *Morton*.

"The court posited that the 'central question' before it is 'whether we should limit the applicability of the pollution exclusion clause to traditional environmental pollution claims.'"

Discussing *Morton*, the court revisited the history behind the drafting of the standard pollution exclusion in the early 1970s, and expressly noted that the "crucial inquiry" was not how the term "sudden and accidental" should be interpreted but, rather,

> whether the courts of this state should give effect to the literal meaning of an exclusionary clause that materially and dramatically reduces the coverage previously available for property damage caused by pollution, under circumstances in which the approval

> of the exclusionary clause by state regulatory authorities was induced by the insurance industry's representation that the clause merely "clarified" the scope of the prior coverage.[46]

The *Nav-Its* court further noted that, in *Morton*, it applied the doctrine of reasonable expectations, predicated on the "common understanding of state regulators," that the overarching purpose of the standard pollution exclusion was to deny coverage for intentional polluters. Thus, the court "imputed the reasonable expectations of the New Jersey insurance regulatory authority to insureds," construing the standard pollution exclusion to provide coverage identical with that under the previous occurrence-based policy.[47] As the *Nav-Its* court pointed out, *Morton* was grounded in the fundamental and equitable principle that the insurance industry had failed to disclose the true intent behind its drafting of the standard exclusion.

> In light of the insurance industry's failure to disclose the "intended effect of the significant exclusionary clause," while at the same time "profit[ing] from that nondisclosure by maintaining pre-existing rates for substantially-reduced coverage," we concluded that it was fair for the industry to "be required to bear the burden of its omission by providing coverage at a level consistent with its representations to regulatory authorities."[48]

The *Nav-Its* court observed that, as with the introduction of the standard pollution exclusion in the early 1970s, the insurance industry also presented testimony to state insurance regulators in the 1980s regarding the intended purpose of the absolute pollution exclusion. Referring to the hearings conducted before the New Jersey insurance regulators, the *Nav-Its* court emphasized that it had "not been presented with any compelling evidence that the pollution exclusion clause in the present case, when approved by the [New Jersey] Department of Insurance, was intended to be read as broadly as Selective urges."[49] The court emphasized that if it were to accept Selective's interpretation of its pollution exclusion, "we would exclude essentially all pollution hazards except those falling within the limited 'exception' for exposure within a structure resulting from a release of pollutants 'within a single forty-eight hour period.'"[50] The court ultimately rejected Selective's proffered interpretation as "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."[51]

"Referring to the hearings conducted before the New Jersey insurance regulators, the Nav-Its court emphasized that it had 'not been presented with any compelling evidence that the pollution exclusion clause in the present case, when approved by the [New Jersey] Department of Insurance, was intended to be read as broadly as Selective urges.'"

Based on its review of the historical development of the absolute pollution exclusion, the *Nav-Its* court stated: "[W]e are confident that the history of the [absolute] pollution-exclusion clause in its various forms demonstrates that its purpose was to have a broad exclusion for traditional environmentally related damages."[52] In reaching that conclusion, the *Nav-Its* court again relied on *Morton*, quoting the following passage:

> Rather than "clarify" the scope of coverage the clause virtually eliminated pollution-caused property-damage coverage, without any suggestion by the industry that the change in coverage was so sweeping or that rates should be reduced. For those reasons, we decline to enforce the [ ] pollution exclusion clause as written. To do so would contravene this State's public policy requiring regulatory approval of standard industry-wide policy forms to assure fairness in rates and in policy content, and would condone the industry's misrepresentation to regulators in New Jersey and other states concerning the effect of the clause.[53]

Underscoring the import of the above passage, the *Nav-Its* court further emphasized:

> The touchstone of our decision in *Morton* was that the insurance industry may not seek approval of a clause restricting coverage for the asserted reason of avoiding catastrophic environmental pollution claims and then use that same clause to exclude coverage for claims that a reasonable policyholder would believe were covered by the insurance policy. Moreover, our conclusion that the scope of the pollution exclusion should be limited to injury or property damage arising from activity commonly thought of as traditional environmental pollution is consistent with the choice of the policy terms "discharge, dispersal, release or escape" in Selective's policy.[54]

In closing, the New Jersey Supreme Court again reiterated the import of *Morton* by making this "final observation":

> [T]he insurance industry has revised its policies in the past to provide for the exclusion of certain coverages. We will review each change on the record presented. We emphasize that industry-wide determinations to restrict coverage of risks, particularly those that affect the public interest, such as the risk

of damage from pollution, environmental or otherwise, must be fully and unambiguously disclosed to regulators and the public.[55]

VI. Conclusion

With *Nav-Its*, the New Jersey Supreme Court joins the majority of jurisdictions that have addressed the absolute pollution exclusion and found it to be restricted to traditional environmental pollution claims. But *Nav-Its* has gone one step further. The "final observation" in the *Nav-Its* opinion presents a cautionary message to the insurance industry. Going forward, the insurance industry may not restrict coverage through the adoption of exclusionary language and provisions unless the true intent and purpose of that exclusion is "unambiguously disclosed to regulators and the public." Only through such full disclosure can the reasonable expectations of insureds be protected. The teachings of *Nav-Its* and *Morton* demand this.

For *Nav-Its* and *Morton* make clear that the insurance industry must act fairly with its insureds. The industry has an affirmative obligation not to conceal from state regulatory authorities and the public what it truly intends to exclude from coverage. Consequently, when exclusionary forms are submitted to state insurance regulators for approval, it is incumbent upon the insurance industry to clearly identify what effect that exclusion will have in terms of coverage and premium payments. To the extent such full disclosure is found wanting, *Nav-Its* and *Morton* instruct that the exclusion will not be enforced as written.

Whether the teachings of *Nav-Its* will be followed by other jurisdictions is yet to be seen. But policyholders facing the insurer's argument that the absolute pollution exclusion should be broadly construed to cover matters beyond traditional environmental pollution claims should not hesitate to present the regulatory history created by the insurance industry when it sought state approval for that exclusion. That record discloses the true intent and purpose behind the exclusion's adoption and the insurance industry should be held accountable for its own representations.

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[1] MacKinnon v. Truck Ins. Exchange, 31 Cal. 4th 635, 642, fn.2, 73 P.3d 1205, 1209, fn.2, 3 Cal. Rptr.3d 228, 233, fn.2 (2003). In *MacKinnon*, the court concluded personal injuries resulting from a landlord's negligent use of pesticides in his apartment complex was covered under the landlord's commercial general liability policy. In holding that the absolute pollution exclusion did not bar coverage, the court noted that the definition of "pollutant," when read in conjunction with the exclusion's triggering words, "discharge," "dispersal," "release," and "escape," conjured up what would commonly be thought of as "conventional environmental pollution" for which the "pollution exclusion was primarily targeted." *MacKinnon*, 31 Cal. 4th at 652–53, 73 P.3d at 1216, 3 Cal. Rptr. 3d at 242–243.

[2] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 869 A.2d 929 (2005).

[3] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J.1, 629 A.2d 831 (1993), *cert. denied*, 512 U.S.1245 (1994). The *Morton* decision involved what is commonly referred to as the standard pollution exclusion, which contains the "sudden and accidental" exception. The *Morton* court ultimately concluded that because the insurance industry had misrepresented to state insurance regulators the true intent of the exclusion, the insurance industry would be held accountable by bearing "the burden of its omission by providing coverage at a level consistent with its representations to regulatory authorities." *Morton*, 134 N.J. at 79–80, 629 A.2d at 876.

[4] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J. 1, 31, 629 A.2d 831, 848 (1993).

[5] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J. 1, 31, 629 A.2d 831, 849 (1993).

[6] American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 489, 687 N.E.2d 72, 79, 227 Ill. Dec. 149, 156 (1997).

[7] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J. 1, 32, 629 A.2d 831, 849 (1993); American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 489, 687 N.E.2d 72, 80, 227 Ill. Dec. 149, 157 (1997).

[8] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J.1, 32–33, 629 A.2d 831, 849 (1993) (and cases and authorities cited therein).

[9] American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 490, 687 N.E.2d 72, 80, 227 Ill. Dec. 149, 157 (1997).

[10] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J. 1, 33, 629 A.2d 831, 849–50 (1993):

> Foreseeing an impending increase in claims for environmentally-related losses, and cognizant of the broadened coverage for pollution damage provided by the occurrence-based CGL policy, the insurance industry drafting organizations began in 1970 the process of drafting and securing regulatory approval for the standard pollution exclusion clause. "The insurer's primary concern was that the occurrence-based policies, drafted before large scale industrial pollution attracted wide public attention, seemed tailor-made to extend coverage to most pollution situations."

(quoting E. Joshua Rosenkranz, Note, The Pollution Exclusion Through The Looking Glass, 74 Geo. L.J. 1237, 1251 (1986)).

[11] Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J. 1, 35–36, 629 A.2d 831, 851 (1993). The *Morton* court noted that this explanatory memorandum was essentially the "only explanation offered to New Jersey officials" as to the scope and purpose of exclusion "f." *Morton*, 134 N.J. at 36, 629 A.2d at 851. The court further observed that once regulatory approval was perfected, the "specific provisions of the pollution-exclusion clause ordinarily were not negotiable by purchasers of CGL policies." In short, the one and only time that exclusion "f" was subject to any "arms-length evaluation" occurred "only when the clause was submitted to and reviewed by state regulatory authorities." *Morton*, 134 N.J. at 37, 629 A.2d at 851–52.

[12] American States Ins. Co. v. Koloms,177 Ill.2d 473, 491, 687 N.E.2d 72, 80, 227 Ill. Dec.149, 157 (1997).

[13] American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 491–92, 687 N.E.2d 72, 80–81, 227 Ill. Dec.149, 157–158 (1997). Later, some courts looked beyond whether a temporal connotation should be affixed the term "sudden" and, instead, focused on the insurance industry's representations made

to state regulatory officials during the approval process, in terms of analyzing whether the insurance industry should be estopped from disavowing those statements. *See, e.g.*, Morton International, Inc. v. General Accident Ins. Co., 134 N.J.1, 36–43, 629 A.2d 831, 851–855 (1993); Joy Technologies, Inc. v. Liberty Mut. Ins. Co., 187 W.Va. 742, 421 S.E.2d 493, 499 (1992).

[14] *See* Comprehensive Environmental Response, Compensation and Liability Act, 42 *U.S.C.* § 9601, *et seq.*; Lorelie S. Masters, *Absolutely Not Total: State Courts Recognize The Historical Limits Of The "Absolute" and "Total" Pollution Exclusions*, Envtl. Claims J., Vol. 15, No. 4, at 457 (Autumn 2003); 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, 29–32 (1998); American States Ins. Co. v. Koloms,177 Ill.2d 473, 492, 687 N.E.2d 72, 81, 227 Ill. Dec.149, 158 (1997); Andersen v. Highland House Co., 93 Ohio St. 3d 547, 550, 757 N.E.2d 329, 333 (2001).

[15] American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 492, 687 N.E. 2d 72, 81, 227 Ill. Dec.149, 158 (1997).

[16] American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 492–493, 687 N.E.2d 72, 81, 227 Ill. Dec.149, 158 (1997) (citations omitted; emphasis in original); *See also* Vantage Development Corp., Inc. v. American Environmental Technologies Corp., 251 N.J. Super. 516, 525, 598 A.2d 948, 953 (Law Div. 1991), where trial court emphasized that absolute pollution exclusion was drafted for purpose of avoiding the "enormous expense and exposure resulting from the 'explosion' of *environmental* litigation." (emphasis added).

[17] Transcript of Proceedings, *Hearing on the Proposed Exclusion of Sudden and Accidental Pollution Coverage From General Liability Policies*, State of New Jersey, Department of Insurance (December 18, 1985) (hereafter "Transcript of Proceedings before New Jersey Department of Insurance").

[18] Transcript of Proceedings before New Jersey Department of Insurance, at 4–6.

[19] Transcript of Proceedings before New Jersey Department of Insurance, at 5. According to Richard S. Biondi, an insurance industry representative who testified at the hearing, although the new exclusion was being introduced to preclude pollution coverage which had been found available under exclusion "f," there would be no decrease in rates. *Id.* at 37, 42.

[20] Transcript of Proceedings before New Jersey Department of Insurance, at 8. As Mr. Averill explained, ISO is a not-for-profit corporation that provides a variety of rating and advisory and statistical services for the insurance industry. One of ISO's services is to develop standard policy forms and endorsements used by the insurance industry. *Id.* at 9. *See also* Kimber Petroleum Corp. v. Travelers Indemnity Co., 298 N.J.Super., 286, 296, 689 A.2d 747, 752 (App. Div.), *certif. denied*, 150 N.J. 26, 695 A.2d 669 (1997).

[21] Transcript of Proceedings before New Jersey Department of Insurance, at 9–10.

[22] Transcript of Proceedings before New Jersey Department of Insurance, at 10–11.

[23] Transcript of Proceedings before New Jersey Department of Insurance, at 13–19.

[24] Transcript of Proceedings before New Jersey Department of Insurance, at 19.

[25] Transcript of Proceedings before New Jersey Department of Insurance, at 15.

[26] Transcript of Proceedings before New Jersey Department of Insurance, at 22–26.

[27] Transcript of Proceedings before New Jersey Department of Insurance, at 31.

[28] Transcript of Proceedings before New Jersey Department of Insurance, at 56–62.

[29] Transcript of Proceedings before New Jersey Department of Insurance, at 63. *See also* Kimber Petroleum Corp. v. Travelers Indemnity Co.,298 N.J. Super.286, 298–299, 689 A.2d 747, 754 (App. Div.), *certif. denied*, 150 N.J.26, 695 A.2d 669 (1997), where Justice Wallace — who authored the *Nav-Its* opinion, but was then sitting on the New Jersey Superior Court, Appellate Division — observed that the insurance industry had not misled New Jersey regulators when it consistently maintained that the absolute pollution exclusion was designed to address only traditional environmental pollution claims, except for certain losses involving completed operations and products hazards coverage.

[30] Kimber Petroleum Corp. v. Travelers Indemnity Co., 298 N.J. Super. 286, 297, 689 A.2d 747, 752 (App. Div.), *certif. denied*, 150 N.J. 26, 695 A.2d 669 (1997). In considering various ISO documents that contained insurance industry official comments made around the time the absolute pollution exclusion was being evaluated for approval by New Jersey and other state regulators, the court noted that the insurance industry did not intend the scope of the new exclusion to be all inclusive. Rather, these official comments made clear that the exclusion was principally drafted to address the costly efforts incurred in responding to traditional environmental damage claims. One ISO document provided a telling response as to the intended scope of the new exclusion:

> [T]here are situations involving a discharge, dispersal, etc. of toxic materials which do not fall within the scope of the exclusion. Examples of this are situations coming within the products hazard since a bodily injury or property damage occurring to a consumer, for instance, is not within the exclusion. A similar example would be the completed operations hazard since the use of the present tense verbs "working" and "are performing" in subsection (d) of Exclusion f.(1.) suggests that it does not apply to operations that are completed.
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> One word of caution is appropriate here. Note that section (2) of the exclusion (which deals with the "clean-up," etc. aspect) seems unlimited and would defeat coverage for those types of costs, however caused and wheresoever occurring. *This is particularly significant since these types of costs and liabilities have, to date, been by far the most expensive aspect of the pollution problem.* Kimber Petroleum, 298 N.J.Super. at 297-298, 689 A.2d at 753 (emphasis added).

[31] Similar representations were made by insurance industry representatives to Texas regulators in 1985 as well. *See* Transcript of Proceedings, *Hearing to Consider, Discuss, and Act on Commercial General Liability Forms Filed by the Insurance Service Office, Inc.*, Texas State Board of Insurance, No. 1472, Vol. III (Oct. 31, 1985). During that official proceeding, a Liberty Mutual Insurance Company representative, Ward Harrel, stated in response to the hypothetical of a Clorox bottle falling from a shelf in a grocery store and resulting in personal injury, that while the absolute pollution exclusion could be read broadly to bar coverage for that injury, nonetheless:

> I don't know anybody that's reading the policy that way. . . . [O]ur insureds would be at the State Board . . . quicker than a New York minute if, in fact, every time a bottle of Clorox fell off a shelf at a grocery store and we denied the claim because it's a pollution loss.

(*Id.* at 7–8). *See also* Richardson v. Nationwide Mut. Ins. Co., 826 A.2d 310, 334 (D.C. 2003) (court noting that during 1980s when approval of absolute pollution exclusion was being sought, the "insurance industry sang a tune markedly different from the position now being taken"). *rehearing en banc granted and op. vacated*, 832 A.2d 752 (D.C. 2003).

[32] *See, e.g.*, Vantage Development Corp. v. American Environmental Technologies Corp., 251 N.J. Super. 516, 528, 598 A.2d 948 (Law Div. 1991) (absolute pollution exclusion barred coverage for clean-up and containment of oil allegedly spilled on insured's property by vandals: "The purpose of the exclusion, given its historical evolution, is to accomplish that which the language of the special notice asserts — to 'absolutely' eliminate coverage for pollution claims, however caused."); A&S Fuel Oil Co., Inc. v. Royal Indemnity Co., Inc., 279 N.J. Super. 367, 652 A.2d 1236 (App. Div. 1995) (no coverage for owner/operator of fuel tank that spilled heating oil into river for costs of containing and remediating spill).

[33] *See, generally*, MacKinnon v. Truck Ins. Exchange, 31 Cal. 4th, 635, 73 P.3d 1205, 3 Cal.Rptr. 3d 228 (2003); *See also* Lititz Mutual Ins. Co. v. Steely, 567 Pa. 98, 785 A.2d 975 (2001), where Pennsylvania Supreme Court held absolute pollution exclusion did not bar coverage for personal injuries sustained from ingestion of lead paint chips and, thus, parted company with its decision two years earlier, where the court had concluded that the absolute pollution exclusion barred coverage for personal injuries sustained by construction worker who fell in ditch after being exposed to concrete curing compound fumes. Madison Construction Co. v. Harleysville Mut. Ins. Co., 557 Pa. 595, 735 A.2d 100 (1999).

[34] *See, e.g.*, American States Ins. Co. v. Koloms, 177 Ill. 2d 473, 489, 687 N.E.2d 72, 79, 227 Ill. Dec.149, 156 (1997) (Illinois Supreme Court holding that absolute pollution exclusion did not bar coverage for personal injury claims caused by carbon monoxide fumes emanating from malfunctioning furnace in commercial building. Based on historical purpose of exclusion, the court restricted its application to traditional environmental pollution claims); Western Alliance Ins. Co. v. Gill, 426 Mass.115, 118, 686 N.E.2d 997, 999 (1997) (following *Koloms*' lead, Massachusetts high court ruled that absolute pollution exclusion must be construed in a "common sense" manner and, thus, a reasonable policyholder would not expect that coverage would be barred for personal injuries suffered by patron at insured's restaurant from exposure to carbon monoxide, since the loss did not involve environmental pollution but, instead, arose during insured's normal business activities); Andersen v. Highland House Co., 93 Ohio St. 3d 547, 551–552, 757 N.E.2d 329, 334 (2001) (based on history and original purpose behind drafting of absolute pollution exclusion, Ohio Supreme Court concluded the exclusion did not bar coverage for personal injuries resulting from exposure to carbon monoxide fumes emitted from defective heating unit in apartment complex); MacKinnon v. Truck Ins. Exchange, 31 Cal. 4th 635, 73 P.3d 1205, 1209–1211, 3 Cal.Rptr.3d 228, 234–236 (2003) (tracing historical purpose of absolute pollution exclusion, California Supreme Court concludes exclusion was never intended to bar coverage in a non-traditional environmental pollution context, where personal injuries resulted from tenant's exposure to pesticides used to eradicate yellow jackets at apartment complex; a reasonable policyholder would not have expected that the act of spraying pesticides in this situation was an act of pollution); Belt Painting Corp. v. TIG Ins. Co., 100 N.Y. 2d 377, 384–387, 795 N.E.2d 15, 763 N.Y.S.2d 790 (2003) (based on genesis of absolute pollution exclusion, New York's highest court held the exclusion did not bar coverage for personal injuries resulting from inhaling paint or solvent fumes in office building where insured was conducting its normal business activities of stripping and painting work; the court was reluctant to adopt an interpretation of the exclusion that was not consistent with "common speech").

[35] *See, e.g.*, Peace v. Northwestern National Ins. Co., 228 Wis.2d 106, 596 N.W.2d 429 (1999) (Wisconsin Supreme Court concluding absolute pollution exclusion bars coverage for personal injury sustained from ingestion of lead paint); Deni Assoc. of Fla., Inc. v. State Farm Fire & Cas. Ins. Co., 711 So.2d 1135, 1139 (1998) (Florida Supreme Court concluding that personal injuries sustained from being sprayed with insecticide is not covered by virtue of absolute pollution exclusion and, further, rejecting history and purpose of exclusion as irrelevant to a proper interpretation).

[36] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 112–113, 869 A.2d 929, 930 (2005).

[37] When the matter was briefed before the trial court, Selective took the position that there was no conflict of law issue involved because the law in New Jersey and Pennsylvania was similar with regard to the absolute pollution exclusion. Accordingly, the coverage issue regarding the interpretation to be accorded the absolute pollution exclusion was analyzed under New Jersey law throughout the litigation. But even if there had been a conflict between Pennsylvania and New Jersey law, New Jersey law would have been applied. *See, e.g.*, J. Josephson v. Crum & Forster, 293 N.J. Super. 170, 679 A.2d 1206 (App. Div. 1996) (court applying New Jersey law to Pennsylvania waste site where policyholder had his "manifested" waste taken by licensed haulers).

[38] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 113, 869 A.2d 929, 930 (2005).

[39] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 113–114, 869 A.2d 929, 930–931 (2005).

[40] In Leo Haus, Inc. v. Selective Ins. Co., 353 N.J. Super. 67, 801 A.2d 419 (App. Div. 2002), the court concluded that Selective's absolute pollution exclusion should not be construed as limited only to traditional environmental pollution claims. In so holding, that court distinguished another appellate panel's decision, Byrd v. Blumenreich, 317 N.J. Super. 496, 722 A.2d 598 (App. Div. 1999), which concluded that another form of the absolute pollution exclusion did not bar coverage for personal injuries sustained from the ingestion of lead paint in an apartment building. *Leo Haus*, however, failed to mention or otherwise discuss another appellate panel's decision, S.N. Golden Estates, Inc. v. Continental Cas. Co., 293 N.J. Super. 395, 680 A.2d 1114 (App. Div. 1996), which had expressly recognized that the absolute pollution exclusion was designed to only address traditional environmental pollution claims.

[41] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 114, 869 A.2d 929, 931 (2005). The trial judge, the Honorable William J. Cook, J.S.C., found the reasoning in *S.N. Golden Estates* more persuasive than *Leo Haus*.

[42] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 114–15, 869 A.2d 929, 931 (2005).

[43] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 115, 869 A.2d 929, 931–932 (2005).

[44] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 116, 869 A.2d 929, 932 (2005).

[45] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 118, 869 A.2d 929, 933 (2005).

[46] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 119–121, 869 A.2d 929, 934–935 (2005) (*quoting* Morton International, Inc. v. General Accident Ins. Co. of America, 134 N.J. at 72, 629 A.2d at 872).

[47] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 121, 869 A.2d 929, 935 (2005).

[48] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 121, 869 A.2d 929, 935 (2005) (*quoting Morton*, 134 N.J. at 79–80, 629 A.2d at 876).

[49] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 121–123, 869 A.2d 929, 936–937 (2005).

[50] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 123, 869 A.2d 929, 937 (2005).

[51] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 123–124, 869 A.2d 929, 937 (2005).

[52] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 123, 869 A.2d 929, 936–937 (2005). The *Nav-Its* court found that Selective's pollution exclusion was "much like" the absolute pollution exclusion introduced in the 1980s. *Nav-Its*, 183 N.J. at 121, 869 A.2d at 936.

[53] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 124, 869 A.2d 929, 937 (2005) (*quoting Morton*, 134 N.J. at 30, 629 A.2d at 848).

[54] Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 124, 869 A.2d 929, 937 (2005). The court also pointed out that its decision was consistent with the decisions of the highest courts in several other jurisdictions. *Nav-Its*, 183 N.J. at 124–126, 869 A.2d at 938. One of those decisions was

the Washington Supreme Court's opinion in Kent Farms v. Zurich Ins. Co., 140 Wash.2d 396, 998 P.2d 292 (2000). In *Kent Farms*, the court concluded that personal injuries resulting from a faulty valve in a fuel tank that caused a leak were covered despite the absolute pollution exclusion, because the drafting history of that exclusion indicated that the insurance industry's main objective was to avoid liability for traditional environmental pollution claims. However, it appears that the Washington Supreme Court may have retreated from that earlier position based on its recent decision in Quadrant Corp. v. American States Ins. Co., 154 Wash.2d 165, 110 P.3d 733 (2005) (court holding that absolute pollution exclusion barred coverage for personal injuries resulting from tenant's exposure to waterproofing sealant fumes during construction process).

55 Nav-Its, Inc. v. Selective Ins. Co., 183 N.J. 110, 127, 869 A.2d 929, 939 (2005). In reaching its ultimate conclusion that the absolute pollution exclusion in its various forms may only be applied in the context of traditional environmental pollution claims, the *Nav-Its* court saw "no need to address the ramifications of the [Selective] 48-hour exception and whether it should be read to expand the pollution exclusion clause." *Nav-Its*, 183 N.J. at 127, 869 A.2d at 939. Additionally, to the extent that previous lower court decisions could be read as being in conflict on this particular issue, because of its ultimate holding — that the pollution exclusion clause as presently approved should be limited to traditional environmental pollution — the *Nav-Its* court disapproved of any contrary view expressed in that case law. *Nav-Its*, 183 N.J. at 126, 869 A.2d at 938–939.

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—John E. James
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