

Noteworthy

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The Ontario Court of Appeal has held that the standard absolute pollution liability exclusion does not exclude losses occurring in an indoor, as opposed to a natural outdoor, environment. The Court observed that the historical context of the exclusion suggests that its purpose is to bar coverage for damages arising from environmental pollution.

In *Zurich Insurance Co. v. 686234 Ontario Ltd.*, Justice Borins on behalf of a three-member panel that included Abella and Moldaver, J.J.A., held that the exclusion should not be interpreted “hyperliterally” but should focus on the reasonable expectations of insureds.

Factual Background

The respondent numbered company is the owner of an apartment complex and is insured by two commercial general liability (CGL) policies issued by Zurich. In two underlying proposed class actions, the plaintiffs allege that they suffered injuries from breathing carbon monoxide which leaked from the respondent company’s furnace. It is alleged the respondent was negligent in maintaining the furnace and in failing to keep it in good working condition, as well as failing to properly inspect repair

work that was allegedly performed negligently by the company hired by the respondent to repair it.

At first instance, Rivard, J. dismissed Zurich’s application for a declaratory judgment that it was not obliged to defend, or indemnify, the respondent, for the damages claimed on the ground that the pollution exclusion applied to the circumstances alleged in the underlying actions. Justice Rivard found that the pollution exclusion clause had an “environmental emphasis and application” pointing to a clear intention to exclude environmental pollution damage from coverage under the policy, as opposed to the accidental discharge of carbon monoxide in the improper repair of a furnace system.

The Court of Appeal’s Analysis

The Court observed that the pollution liability exclusion has been considered much more extensively in the United States than in Canada. In the U.S., insurers have urged a literal interpretation of the text of the exclusion to “attempt to deny the sorts of claims traditionally covered under a basic C.G.L. policy”. On the other hand, insureds have urged that the exclusion be interpreted in the context of the policy and its purpose, the drafting history of the exclusion, and its purpose from the perspec-

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The Incredible Shrinking Absolute Pollution Exclusion

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tive of the insurance industry, together with the objectively reasonable expectations of the parties. Policyholders assert that the exclusion was intended to exclude coverage for natural outdoor environmental pollution and not for routine occurrences that have received long-standing coverage under C.G.L. policies “simply because the cause of the damage fits within a hyperliteral application of the text of the exclusion”.

The Court considered two survey articles reviewing the U.S. case law dealing with the exclusion, as well as the background and purpose of the exclusion.

The Court noted that the author of one of the articles concluded that the exclusion “bars coverage for classic environmental degradation pollution and not tort claims previously conceded to be within the scope of standard C.G.L. coverage”. One of the leading cases referred to by the Court that supports this proposition is *American States Insurance Co. v. Koloms*, 687 N.E. (2d) 72 (S.C.Ill. 1997), a decision discussed in the February 1998 edition of **Noteworthy**.

The Court also observed that there is a “considerable divergence in the American cases that have construed the exclusion, with the result that courts have not reached a clear consensus as to its proper interpretation. This is true even within the context of carbon monoxide poisoning. Cases which have held that the exclusion applies to instances of

carbon monoxide poisoning have applied a literal construction to the exclusion, noting that its language is specific on its face even though a literal interpretation results in a broad application of the exclusion. However . . . the bulk of the carbon monoxide poisoning cases have held that the exclusion does not apply . . . [A] majority of the cases have concluded that damages arising

“construction given to a policy of insurance must not nullify the purpose for which the insurance was sold”

from indoor pollution are not excluded from coverage by the absolute pollution exclusion”. Typical of the cases which have found that the exclusion precludes coverage for damages caused by carbon monoxide poisoning is *Essex Insurance Co. v. Tri-Town Corp.*, 863 F.Supp. 38 (D.Mass. 1994) In *Essex* the court held that the language of the policy was unambiguous and once carbon monoxide was released into the atmosphere causing injuries, even though this occurred as a result of a Zamboni emitting carbon monoxide within a hockey arena, the incident fell within the scope of the exclusion.

The Court turned to the principles of construction that apply to the interpretation of an exclusion clause contained in an

insurance policy and placed great emphasis upon those decisions which indicate that the reasonable expectations of the parties are to be considered so that the “construction given to a policy of insurance must not nullify the purpose for which the insurance was sold”. Among the cases cited in the Court’s discussion are the Supreme Court of Canada’s decisions in *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.*, [1993] 1 S.C.R. 252; *Amos v. Insurance Corp. of British Columbia*, [1995], 3 S.C.R. 405; and *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888.

The Court also found particularly helpful the decision of *Weston Ornamental Ironworks Ltd. v. Continental Insurance Co.*, [1981] I.L.R. 477, an earlier decision of the Ontario Court of Appeal, where, in interpreting an exclusion relating to the loss of personal property as a result of any work performed thereon by the insured, it was held that “the exclusion should not be interpreted in a way which is repugnant to or inconsistent with the main purpose of the insurance coverage but so as to give effect to it”. Thus, even if the exemption clause were found to be clear and unambiguous, it should not be enforced by the courts when the result would be to defeat the main object of the contract or virtually nullify the coverage sought for protection from anticipated risks.

Relying on the *Weston Orna-*

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mental decision, the Court found that it is clear that it has concluded that “even though an exclusion clause may be clear and unambiguous, it will not be applied where: (1) it is inconsistent with the main purpose of the insurance coverage and where the result would be to virtually nullify the coverage provided by the policy; and (2) where to apply it would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased”.

The Court also observed that where there is little or no Canadian authority on a point of insurance law, Canadian courts have turned to American law for assistance. This is particularly so where the same provision, such as the subject exclusion, is in common use by the insurance industry in both countries and where the American authorities have “applied rules of construction not materially different from our own”.

The Court then concluded that the line of American cases that did not literally interpret the exclusion are more persuasive. Justice Borins continued:

“In my view, in construing contracts of insurance, dictionary literalism is often a poor substitute for connotative contextual construction. When the full panoply of insurance contract construction tools is brought to bear on the pollution exclusion, defective maintenance of a furnace giving rise to

carbon monoxide poisoning, like related business torts such as temporarily strong odours produced by floor resurfacing or painting, fail the common sense test for determining what is “pollution”. These represent claims long covered by CGL insurance policies. To apply an exclusion intended to bar coverage for claims arising from environmental pollution to carbon monoxide poisoning from a faulty furnace, is to deny the history of the ex-

“it would produce an unfair and unintended result to conclude, in the context of a CGL policy, that defective machinery maintenance constitutes ‘pollution’, even when it gives rise to carbon monoxide poisoning”

clusion, the purpose of CGL insurance, and the reasonable expectations of policyholders in acquiring the insurance.

There is nothing in this case to suggest that the respondent’s regular business activities place it in the cate-

gory of an active industrial polluter of the natural environment. As I have pointed out, the history of the exclusion demonstrates that it would produce an unfair and unintended result to conclude, in the context of a CGL policy, that defective machinery maintenance constitutes “pollution”, even when it gives rise to carbon monoxide poisoning. In this regard, it is necessary to understand that the exclusion focuses on the act of pollution rather than the resulting personal injury or property damage.

Accepting for the purpose of my conclusion that carbon monoxide is a “pollutant” within the meaning of the exclusion, [thus, the Court did not believe it necessary to address this issue, in the circumstances] although it is arguably clear in its plain and ordinary meaning, the exclusion is overly broad and subject to more than one compelling interpretation as is evident from its construction by American courts. Given that the exclusion is capable of more than one reasonable interpretation, it is ambiguous and should be interpreted in favour of the respondent. Based on the coverage provided by a CGL policy, a reasonable policyholder would expect that the policy insured the very risk that occurred in this case. A

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reasonable policyholder would, therefore, have understood the clause to exclude coverage for damage caused by certain forms of industrial pollution, but not damages caused by the leakage of carbon monoxide from a faulty furnace. In my view, the policy provisions should be construed to give effect to the purpose for which the policy was acquired.”

In the result, the Court held that Zurich had both a duty to defend the underlying claims and to indemnify the respondent for any damages caused by the carbon monoxide leak.

Commentary

The Court’s approach to the interpretation of the absolute pollution exclusion appears to represent a significant change in past practice. For the most part, if a court finds that the wording of an exclusion is unambiguous, the analysis stops there. In our view, the Court here has found that the more important consideration is what the reasonable expectations of the parties (and particularly the insured) were when interpreting the exclusion.

This approach to contractual interpretation appears consistent with the recent approach

taken by the Court of Appeal in respect of statutory interpretation in *Hernandez v. 1206625 Ontario Inc.*, considered in the 2002, No. 9 edition of **Noteworthy**.

Both approaches appear to signal a desire by the Court to take a purposeful or functional approach to statutory and contractual interpretation as opposed to the traditional technical approach of first determining whether the language used is clear by applying a literal (or as Borins, J.A. terms it, “hyperliteral”) interpretation of the wording found in a statute or contract.

If this is the trend that the

