2015 No. 5

Noteworthy

HUGHES AMYS LLP
BARRISTERS & SOLICITORS

EFFECTIVE LITIGATION SINCE 1918

The Expanding Scope of the Absolute Pollution Exclusion

The "absolute pollution exclusion" is a standard exclusion clause commonly found in Commercial General Liability ("CGL") policies. It purports to preclude coverage for losses arising out of the discharge or escape of pollutants at or from an insured's premises. The term "pollutant" is commonly defined in CGL policies as including "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapour, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed".

Very recently, the British Columbia Court of Appeal in *Precision Plating Ltd. v. Axa Pacific insurance Co.*, considered the leading case law to date on this provision, and appears to have somewhat broadened the approach to determining its application.

By way of background, in *Zurich Insurance Co. v. 686234 Ontario Ltd*, the Ontario Court of Appeal was the first Canadian court to formulate an approach to the interpretation of this pollution exclusion clause.

The issue before the Court of Appeal was the scope of the absolute pollution exclusion. Given the lack of Canadian jurisprudence at the time, the Court undertook a comprehensive analysis of the history and purpose of the exclusion clause, including a review of relevant American case law and academic writing. In doing so, the Court cited and endorsed the view of American professor, J.W. Stempel, who concluded that the pollution exclusion was meant to bar "coverage for classic environmental degradation pollution and not tort claims previously conceded to be within the scope of standard CGL coverage".

The Court also summarized two divergent lines of American jurisprudence on the interpretation of the absolute pollution exclusion. In the first line of cases, the American courts adopted what the Court of Appeal referred to as a "hyperliteral" interpretation of the wording of the exclusion. This approach often resulted in excluding from coverage claims arising from common hazards that were not normally viewed as pollution. The Court cited as an example of this hyperliteral interpretation a slip and fall claim involving spilled bleach, which while technically constitutes a "spilled chemical" would not normally be considered "pollution" in the traditional sense of the term.

The second line of cases applied a contextual interpretation to the exclusion clause, taking into account the context of the insurance policy, the drafting history and the purpose of the exclusion, the presence of any ambiguity in the wording of the clause together with the objectively reasonable expectations of the parties at the time of entering the insuring agreement".

The Court in *Zurich* found the second line of American cases more persuasive and, accordingly, adopted what it referred to as a "connotative contextual construction" approach to the interpretation of the absolute pollution exclusion. In applying this approach, the Court found that the pollution exclusion in Zurich's policy was overtly broad as its literal dictionary interpretation would render carbon monoxide a "pollutant". The Court therefore held that the exclusion clause was ambiguous and that the ambiguity was to be resolved in favour of the insured. Further, given the historical context of the exclusion, the Court concluded that its purpose was to exclude "active industrial polluters of the natural environment" and not coverage

(Continued on page 2)

IN THIS ISSUE

The Expanding Scope of the Absolute Pollution Exclusion

Michael Teitelbaum and Yulia Pesin

Firm News

(Continued from page 1)

for claims such as carbon monoxide emission from a faulty furnace of a residential landlord.

In the result, the Court held that Zurich had both a duty to defend the claim and to indemnify the insured for any damages found against it. In reaching its conclusion, the Court stated:

> *There is nothing in this case to suggest that the respondent's regular business activities place it in the category 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.*
>
> *…The historical context of the exclusion suggests that its purpose is to bar coverage for damages arising from environmental pollution, and not the circumstances of this case in which a faulty furnace resulted in a leak of carbon monoxide. Based on the coverage provided by the CGL policy, a reasonable policyholder would, therefore, have understood the clause to exclude coverage from damage caused by certain forms of industrial pollution, but not damages caused by the leakage of carbon monoxide from a faulty furnace….*

Thus, in adopting a connotative contextual construction approach and emphasizing that the pollution exclusion applied to "active industrial polluters", the Court in *Zurich* took a restrictive view of the absolute pollution exclusion and limited the application of the exclusion to more traditional forms of environmental contamination. In recent cases, however, both the Ontario and the British Columbia Courts of Appeal, appear to have broadened the application of this exclusion while still following the core interpretative principles set out in *Zurich*.

For instance, in the case of *ING Insurance of Canada v. Miracle*, the Ontario Court of Appeal clarified and expanded its prior reasons in *Zurich*. In *Miracle*, the insured owned and operated a convenience store and a gas bar. An action was brought against the insured when gasoline escaped from an underground storage tank on its property and caused damage to adjacent land owned by Canada. Miracle sought coverage for the claim pursuant to its CGL policy with ING Insurance. ING, in turn, sought a declaration that the claim was excluded from coverage by the operation of the pollution exclusion found in its policy.

In determining whether the claims brought against the insured came within the scope of the policy's pollution exclusion, the Court applied the connotative contextual construction approach adopted in *Zurich*.

The Court, however, expanded the application of the pollution exclusion by denying that the effect of *Zurich* was to restrict the reach of the pollution exclusion to only those who can be described as "active industrial polluters". The Court stated that that such an approach would be contrary to the fortuity principle of insurance law and would render the pollution exclusion clause virtually useless. Further, it explained that the term "active industrial polluter" as it appears in *Zurich* should not be given a "hyperliteral" interpretation itself, as to do so would result in the Court falling into the very interpretational trap that *Zurich* sought to avoid.

Instead, the Court promoted a "commercially sensible interpretation" of the wording of the exclusion and held that the pollution exclusion extends to businesses that participate in activities that carry "a known risk of pollution and environmental harm" even if such businesses are not "active industrial polluters". Applying these principles to the case at bar, the Court of Appeal concluded that the claims against the insured fell within the pollution exclusion thereby disentitling the insured to coverage under its CGL policy.

The Court reasoned:

> *Unlike Zurich, in this case, the insured was engaged in an activity that carries an obvious and well-known risk of pollution and environmental damage: running a gas station. Indeed, the statement of claim is framed as a claim for damage to the natural environment caused by a form of pollution… Such a claim fits entirely within the historical purpose of the pollution exclusion, which was "to preclude coverage for the cost of government-mandated environmental clean up under existing and emerging legislation making polluters responsible for damage to the natural environment.*
>
> *Therefore, the claim as pleaded falls squarely and unambiguously within the language of the exclusion clause…Indeed, it would take a "hyperliteral" reading of the language of Zurich, detached from the facts and issues considered in that case, to conclude otherwise.*
>
> *I therefore conclude that the pollution liability exclusion, as applied to the circumstances of this case, is neither ambiguous nor contrary to the parties' reasonable expectations.*

Most recently in *Precision*, the British Columbia Court of Appeal appears to have further expanded the scope of the pollution exclusion clause. In *Precision*, the insured was in the business of electroplating. It was sued by several tenants of the commercial strata building in which it was located for damages resulting from chemical solutions that seeped from the insured's vats into the neighbouring businesses. The seepage of the chemical solutions was caused by a fire that broke out in the insured's premises resulting in the activation of its sprinkler system which in turn caused its chemical vats to overflow. The insured held a CGL policy with Axa: however, Axa denied coverage for the claims pursuant to the absolute pollution exclusion found in its policy.

The British Columbia Court of Appeal overturned the lower court decision and found that the pollution exclusion in Axa's CGL policy excluded damages caused by the release of the insured's

(Continued on page 3)

(Continued from page 2)

toxic chemicals which itself was partially caused by the fire. The Court reaffirmed the connotative contextual interpretative approach espoused in *Zurich*. However, it qualified the application of this approach by stating that it was necessary only when the literal dictionary interpretation of the exclusion clause would fail to result in a commercially sensible interpretation of the policy. Specifically, the Court took the following approach:

> *A strict and literal interpretation of the CGL Policy would exclude coverage for liability arising out of a release of the chemicals stored by Precision. I understand Zurich and Miracle to suggest that a contextual examination of the policy is appropriate where a literal interpretation may lead to a result that is inconsistent with the insured's reasonable expectations or is inconsistent with the main purpose of the insurance coverage.*
>
> *Precision…could have no reasonable expectation that it would be indemnified against liability for the escape of chemicals from the vats. Therefore, applying both the literal wording of the policy or a contextual approach leads to the same result: the policy excludes coverage for the risk of the insured being found liable for the escape of chemicals from vats.*

The Court found that the trial judge erred in his analysis by framing the issue "as a question of causation of the damages, rather than causation of the liability". Specifically, the Court explained that the CGL policy, read with the exclusion, afforded coverage for the insured's source of liability as alleged in the pleadings and not for the potential damages of the plaintiff.

The distinction between the cause of the damage versus the source of the liability was also emphasized in *Zurich*, where the Court held that "it is necessary to understand that the exclusion focuses on the act of pollution, rather than the resulting personal injury or property damage". In *Zurich*, for instance, the source of the insured's liability was the faulty maintenance of its furnace, which is not an act of pollution. The cause of the damages alleged by the plaintiffs, however, was the escape of carbon monoxide, which under a literal dictionary interpretation of the absolute pollution exclusion clause could be classified as pollution. In contrast, in *Precision*, both the source of the insured's liability and the cause of the damage to the plaintiffs was the escape of toxic chemicals from the insured's property, which according to the Court, clearly fell within the common sense meaning of the pollution exclusion.

Further, the Court held that both *Zurich* and *Miracle* were distinguishable from the facts in *Precision*. With respect to *Zurich*, the distinction is clear and appears to lie in the fact that the exclusion clause in *Zurich* was found to be ambiguous and the fact that the insured was a residential building owner who was neither an "active industrial polluter" nor involved in a business that carried a known risk of pollution. It is not clear, however, why the Court held that *Miracle* was also a distinguishable case as, in fact, both the factual circumstances and the application of the legal principles by the Court in *Miracle* appear to be analogous to the decision in *Precision*.

Lastly, while not directly the subject of this article's analysis, of note is the fact that the Court in *Precision* also briefly dealt with the issue of concurrent causation as some of the claims raised against the insured were with respect to damages caused by both the fire and the chemical solution spill. The Court cited the Supreme Court of Canada decision in *Derksen v. 539938 Ontario Ltd.* on concurrent causation, in holding that the wording in Axa's policy was sufficient to exclude liability associated with the release of pollutants as a concurrent cause.

In *Derksen*, the Supreme Court held that "if an insurer wishes to oust coverage in cases where covered perils operate concurrently with excluded perils, all it has to do is expressly state it in the insurance policy". The Court provided an example of the language required to fully exclude coverage where a loss arises from more than one cause, where one of the causes is excluded from the policy, which was as follows:

> *We do not insure for such loss regardless of the cause of the excluded event, other causes of the loss, or whether other causes acted concurrently or in any sequence with the excluded event to produce the loss.*

In *Precision,* however, it does not appear that the language in Axa's CGL policy included any wording analogous to the proposed exclusion wording, (often referred to as "anti-concurrent causation" language) cited by the Supreme Court. Instead, the pollution exclusion merely stated that "This insurance does not apply to…damage… *"caused by, contributed to, or arising out of*…pollutants"". The BC Court of Appeal found this wording to be sufficient to exclude coverage for claims where the escape of a pollutant and the eruption of a fire were concurrent causes of the alleged damages. We query whether the Court was correct in its application of the *Derksen* decision in Precision.

With respect to the interpretation of the absolute pollution exclusion, it appears that several general principles can be derived from the case law. The courts' paramount concern appears to be to ensure that the application of the exclusion clause leads to commercially reasonable results. Where a reasonable application of the exclusion cannot be achieved by a literal interpretation of the wording of the clause, the courts favour a contextual, or in the words of the *Zurich* decision, a connotative contextual construction approach. Pursuant to this approach, the exclusion's wording and its historical objective are relevant to the coverage analysis. However, it appears that the ultimate outcome will turn on the nature of the business that causes the pollution exposure.

In *Zurich*, notwithstanding the fact that the language of the pollution exclusion supported a broad application of the clause, the Court declined a "hyperliteral" interpretation of the exclusion. Instead, the Court introduced a connotative contextual approach and

(Continued on page 4)

(Continued from page 3)

appeared to limit the scope of the exclusion to "active industrial polluters".

In *Miracle,* the Court reaffirmed the application of the connotative contextual construction approach to the interpretation of the clause but expanded the scope of the exclusion to apply not only to "active polluters" but also to businesses that carry a known risk of pollution and environmental harm.

Lastly, in *Precision*, the British Columbia Court of Appeal continued to espouse the connotative contextual construction approach. However, the Court highlighted the importance of framing the analysis in terms of the source of the insured's liability rather than the cause of the plaintiff's damage and held that a literal interpretation of the exclusion clause can be applied in instances where it would lead to a commercially sensible interpretation of the policy.

Thus, while in each decision, the pollution exclusion was applied more expansively, there does not ultimately appear to be any conflict in their approach. Arguably, the British Columbia Court of Appeal has simply added another layer to the analysis by saying that a literal approach can be taken in the appropriate case but, if not, the contextual approach should be used. More importantly, in all three cases, the courts, emphasized that the application of the absolute pollution exclusion is strongly dependent on the actual business activities of the insured. Given this most recent development, we await with interest how the absolute pollution exclusion will be applied in future cases.

Firm News

Congratulations to James Maloney

We wish to congratulate James on his election as the Member of Parliament in the riding of Etobicoke-Lakeshore.

We are confident that James will be an outstanding MP and wish him all the best as he assumes this new challenge, in addition to continuing his work at Hughes Amys LLP.

TORONTO

48 YONGE STREET
SUITE 200
TORONTO, ONTARIO
M5E 1G6

TELEPHONE (416) 367-1608
TOLL-FREE (800) 565-1713
FACSIMILE (416) 367-8821

HUGHES AMYS LLP
BARRISTERS & SOLICITORS

www.hughesamys.com

HAMILTON

25 MAIN STREET WEST
SUITE 2100
HAMILTON, ONTARIO
L8P 1H1

TELEPHONE (905) 577-4050
TOLL-FREE (877) 858-8234
FACSIMILE (905) 577-6301