

ALERT

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Indiana Supreme Court Again Finds the Pollution Exclusion Ambiguous, But Indicates a Possible Way Forward

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Enforcing the pollution exclusion clause in a commercial general liability policy continues to be problematic for insurers in the state of Indiana. On March 22, 2012, the Indiana Supreme Court once again held that the absolute pollution exclusion is unenforceable because the term “pollutant” is ambiguous. *State Auto. Mut. Ins. Co. v. Flexdar, Inc.*, No. 49S02-1104-PL-199, *Slip Op.* (Ind. March 22, 2012).

Flexdar, Inc. (Flexdar) manufactured rubber stamps and printing plates at its facility in Indiana from 1994 through 2003. Flexdar’s manufacturing process used a chemical solvent called trichloroethylene (TCE). In late 2003 and early 2004, TCE was discovered in the soil and ground water on and off the Flexdar site. The Indiana Department of Environmental Management (IDEM) informed Flexdar that it would be liable for the cleanup costs. Flexdar maintained commercial general liability and umbrella insurance policies with State Automobile Mutual Insurance Company (State Auto) during the relevant period and requested indemnification from State Auto. State Auto agreed to defend Flexdar against IDEM’s claims under a reservation of rights. State Auto then filed a declaratory judgment action against Flexdar seeking a ruling that coverage was precluded by the absolute pollution exclusion.

State Auto relied on its absolute pollution exclusion, which defined the term “pollutants” to mean: “any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.” State Auto also cited the Indiana “Business Operations” endorsement, which provided in pertinent part: “This Pollution Exclusion applies whether or not such irritant or contaminant has any function in your business, operations, premises, site or location.” Flexdar argued that State Auto’s pollution exclusion was ambiguous and therefore should be construed in favor of coverage. The trial and appellate courts agreed.

The Indiana Supreme Court reviewed its previous decisions that had found the term pollutant, as used in the absolute pollution exclusion, to be ambiguous. *See, e.g., American States Ins. Co. v. Kiger*, 662 N.E.2d 945 (Ind. 1996); *Seymour Mfg. Co. v. Commercial Union Ins. Co.*, 665 N.E.2d 891 (Ind. 1996); *Friedline v. Shelby Ins. Co.*, 774 N.E.2d 37 (Ind. 2002); *Monroe Guar. Ins. Co. v. Magwerks Corp.*, 829 N.E.2d 968 (Ind. 2005). The court maintained that the clause, read literally, would negate virtually all coverage, thereby rendering the exclusion meaningless.

State Auto urged the court to adopt a “common sense approach” and apply the pollution exclusion in situations where the release would ordinarily be characterized as pollution. The court acknowledged that there are two competing views when it comes to interpreting these exclusions, namely: a “literal” approach and a “situational” approach. The court explained that jurisdictions employing a “literal” view of the exclusion generally find the exclusion to be unambiguous in all circumstances. In other words, where a substance is acting in any manner as an irritant or contaminant, damage caused thereby is excluded. The court declined to adopt this view because it eliminates practically all coverage, thus, yielding untenable results. The court explained that jurisdictions applying the “situational” approach tend to look to the factual context and typically uphold the exclusion only in cases of “traditional” environmental contamination. The court again declined to adopt this approach because, in its opinion, such a view can be problematic since what is considered a traditional environmental contaminant may vary over time. Thus, courts would be forced to make a case-by-case determination, which the court deemed inefficient.

Discussing the approach in Indiana, the Supreme Court stated that the insurer can (and should) specify what falls within its pollution exclusion. Accordingly, because State Auto failed to do so, the court found the language to be ambiguous. The court

reasoned that insurance companies “write the policies” and, accordingly, State Auto had the ability to resolve any questions of ambiguity.

Significantly, the court suggested that there may be language that it would consider sufficiently specific. The court noted that in 2005, State Auto did, in fact, revise the pollution exclusion in its Indiana policies to more specifically define the term pollutants. The revision added the following language to the standard definition of pollutants:

Specific examples identified as pollutants include, but are not limited to, diesel, kerosene, and other fuel oils ... carbon monoxide, and other exhaust gases ... mineral spirits, and other solvents ... tetrachloroethylene, perchloroethylene (PERC), trichloroethylene (TCE), methylene chloroform, and other dry cleaning chemicals ... chlorofluorocarbons, chlorinated hydrocarbons, adhesives, pesticides, insecticides ... and all substances specifically listed, identified, or described by one or more of the following references: Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) Priority List Hazardous Substances (1997 and all subsequent editions), Agency for Toxic Substances And Disease Registry ToxFAQs, and/or U.S. Environmental Protection Agency EMCI Chemical References Complete Index.

The court, however, did not rule as to whether this revision would be sufficient to correct any ambiguity in the pollution exclusion.

The court concluded its opinion by recognizing that Indiana precedent has consistently refused to apply pollution exclusions like the one at issue in the case. The court further explained that its past decisions have always required that the language of a pollution exclusion be explicit. The court concluded that it saw no reason to abandon that settled principle.

In the dissent, Justice Sullivan pointed to the 7th Circuit’s recent decision in *Scottsdale Indem. Co. v. Vill. of Crestwood*, 2012 U.S. App. LEXIS 5069 (7th Cir. Mar. 12, 2012), where the court was presented with a similar issue and the pollution exclusion was held enforceable. Justice Sullivan pointed to the logic used in *Crestwood* that the pollution exclusion is meant to preclude coverage for “the ordinary understanding of pollution harms.”

Ultimately, Indiana law has not changed. The pollution exclusion remains unenforceable because the definition of pollutant is ambiguous. This case is significant, however, because the court alluded to language that it might consider sufficiently specific to be enforceable, although it did not provide a definitive answer.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:

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