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The pollution exclusion and nontraditional forms of environmental damage

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The evolution of modern insurance policies has been likened to the history of Holland: When a peril causes catastrophic losses to a large percentage of the insurance industry's customers, and thereby threatens the industry's profitability, the industry shores up the dike with new exclusionary language.[1]

This metaphor's clearest instance is found in the commercial general liability policy's pollution exclusion.

Designed to limit coverage for cost of cleaning up toxic waste sites, the pollution exclusion was introduced in the early 1970s. As originally worded, it eliminated coverage for discharges of pollutants unless the discharge was "sudden and accidental."

However, broad judicial interpretation of the exclusion's sudden-and-accidental exception left insurers on the hook for accidental environmental damage without regard to whether the discharge of pollution was temporally sudden.

To avoid coverage for the burgeoning costs of cleaning up environmental damage, the insurance industry replaced early versions of the pollution exclusion with the "absolute" pollution exclusion.

While a significant minority of jurisdictions have limited the absolute pollution exclusion to traditional environmental pollution, many courts have applied it in a manner that narrows coverage more than most policyholders would expect.

For example, courts have applied the exclusion to preclude coverage for product liability and workplace injury claims regardless of the presence of environmental damage.[2]

The 5th U.S. Circuit Court of Appeals, applying Texas law, recently extended the exclusion's reach even further to preclude coverage for non-toxic rock fragments left over from normal quarry operations.

In *Eastern Concrete Materials Inc. v. ACE American Insurance Co.*, 948 F.3d 289 (5th Cir. 2020), the court held that "rock fines" are a "contaminant" within the meaning of the absolute pollution exclusion in a liability insurance policy covering a rock quarry's operations when they are dispersed or discharged into a creek.

In the court's view, the rock fines were a contaminant even though they did not mix with the creek or pose a health threat. Instead, the court said they qualified as a contaminant because they were not supposed to be in the creek and altered the contours of the creek bed.

FACTUAL BACKGROUND

As recounted in the 5th Circuit's opinion, the insured, Eastern Concrete, operates a rock quarry in New Jersey at which it "drills and blasts large pieces of stone off of the face of [a] rock formation." The stones are then crushed and screened to produce different gradations of stone.

The smallest particles are called rock fines. During normal quarry operations, the rock fines are washed off larger stones and gathered into settling ponds, after which they are removed, dried and stockpiled on site. They are either used at the quarry or sold.

To avoid coverage for the burgeoning costs of cleaning up environmental damage, the insurance industry replaced early versions of the pollution exclusion with the so-called "absolute" pollution exclusion.

Anticipating substantial rain, Eastern Concrete began to lower the water levels in its settling ponds by pumping water, pursuant to a valid permit, into the nearby Spruce Run Creek.

Unfortunately, the quarry manager "accidentally failed to shut off the pumping before the stone fines from the bottom of the settlement ponds began to be pumped into Spruce Run."

As a result, "substantial amounts of rock fines (up to two feet in some places)" were released into the creek.

Although the rock fines changed the flow and contours of the stream, they did not "mix" with the stream in a way that made it impure, dirty or unfit for use.

To the contrary, according to a notice sent by the New Jersey Department of Environmental Protection shortly after the incident, the rock fines posed "no threat to drinking water, nor to anyone who would use the area for fishing nor to the fish that they might catch."

Nevertheless, the department issued "Notices of Violation" to Eastern Concrete, requiring it to remove the rock fines and take preventive measures to stem their migration downstream.

COVERAGE LITIGATION

After completing the prescribed remediation efforts, Eastern Concrete notified its liability insurer of the incident through its Texas insurance broker and demanded reimbursement for the costs of removing the rock fines and of defending the claim.

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In response, the insurer filed a declaratory judgment action in the U.S. District Court for the Northern District of Texas, contending that it had no duty to defend or indemnify Eastern Concrete because the incident fell within its policy's absolute pollution exclusion.

The District Court granted summary judgment for the insurer, and Eastern Concrete appealed.

The 5th Circuit, in an opinion by Judge Edith Jones, affirmed, holding that the policy's absolute pollution exclusion unambiguously precluded coverage.

The exclusion barred coverage for liability "arising out of or in any way related to ... discharge, dispersal, seepage, migration, release or escape of 'pollutants,'" Judge Jones said.

"Pollutants," in turn, was defined as "any solid, liquid ... irritant or contaminant, including, but not limited to ... waste material," including "materials which are intended to be or have been recycled, reconditioned or reclaimed."

Focusing on the meaning of the word "contaminant" in the policy's definition of pollutant, Judge Jones found nothing in the policy that justified limiting the term to hazardous substances that cause environmental damage.

She acknowledged that various dictionaries, including Black's Law Dictionary, restrict the term to substances that "stain, corrupt, or infect . . . to render unfit for use by the introduction of unwholesome or undesirable elements."

She nevertheless treated the rock fines as contaminants based on their "effects on the overall ecosystem." Specifically, she noted that the rock fines altered the contours of the stream, adversely affecting its suitability for use as a habitat for trout and other species.

COURT APPLIES TEXAS LAW

Although Texas applies the Restatement (Second) of Conflict of Laws § 188(1)'s "most substantial relationship" test to choice-of-law questions, the *Eastern Concrete* court ruled that "the place of contracting, not the place of the underlying incident, is the dominant consideration for choice of law in an insurance-coverage dispute."

The court therefore applied the law of Texas, where the policy was issued to Eastern Concrete's parent company, rather than the law of New Jersey, where Eastern Concrete was incorporated and its quarries were located.

The court based its holding that rocks are "contaminants" within the meaning of the pollution exclusion on *Cleere Drilling Co. v. Dominion Exploration & Production Inc.*, 351 F.3d 642 (5th Cir. 2003).

In so doing, the court quoted language in the *Cleere Drilling* opinion stating that "salt water, sand and drilling mud" were contaminants even though they "did not or could not cause environmental damage."

> The 5th Circuit's interpretation of the pollution exclusion to apply to anything that affects "the overall ecosystem" potentially has broad implications.

A close examination of the facts in *Cleere Drilling*, however, raises questions about its applicability to the facts underlying the *Eastern Concrete* decision.

In contrast to the rock fines that sank to the bottom of the creek bed in *Eastern Concrete*, the contaminants at issue in *Cleere Drilling* were "undesirable elements" that "rendered the surface area soiled, stained, impure and almost certainly unfit for its intended use."

These "undesirable elements" included gas and chemically treated drilling mud in addition to the materials mentioned in Judge Jones's opinion.

Judge Jones' interpretation of the pollution exclusion to apply to anything that affects "the overall ecosystem" has potentially broad implications. After all, any form of development affects ecosystems. That is why most projects require environmental impact reports.

Notes

[1] B. Bunshoft and R. Seabolt, The Contractor's Insurance Coverage under Its Liability and Builder's Risk Policies, at 9:24, in Construction Litigation: Representing the Contractor (Wiley Law Publications 1986).

[2] DiMugno & Glad, California Insurance Law Handbook § 45:36 (Thomson Reuters 2019).

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