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Alerts

Seventh Circuit Offers a "More Perspicuous Formula" for Interpreting the Pollution Exclusion

April 17, 2012
Insights for Insurers

Brief Overview

The U.S. Court of Appeals for the Seventh Circuit held that the pollution exclusion precluded coverage for injuries resulting from a village delivering tap water contaminated with perchloroethylene (PCE) to its residents even though the village was not the producer. In the process, the Seventh Circuit recast the Illinois Supreme Court's test for interpreting the pollution exclusion.

Summary

In *Scottsdale Indemnity Company, et al. v. Village of Crestwood, et al.,* 2012 WL 769730 (7th Cir., Mar. 12, 2012), the Seventh Circuit affirmed a district court ruling in favor of plaintiff insurers, finding that coverage is precluded based on the application of the pollution exclusion found in most insurance policies. The insurers brought this declaratory action seeking a determination that they had no duty to defend or indemnify defendant insureds, the village and village officials, in a series of tort suits arising from alleged contamination of the drinking water supply.

According to the allegations in the underlying suits, the village had supplied its residents with water contaminated with PCE. Although village officials knew that PCE from a nearby dry-cleaning establishment leaked into the groundwater tapped by the village's well, the village continued to use the well. Upon learning of the contamination of their water supply, village residents sued the village and its officials seeking damages for the injury to their health. Additionally, the district court consolidated a parallel suit filed by the state of Illinois seeking an injunction requiring the village to finance an inspection and remediation of the alleged contamination.

The insurance policies at issue excluded coverage for "bodily injury, property damage, or personal injury arising out of, or wrongful act(s)' which result in the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants' at any time." They also excluded from coverage expenses arising from orders for "cleaning up . . . or in any way responding to, or assessing the effect of pollutants." The policies defined "pollutants" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

The court found that PCE is a "contaminant" within the meaning of the policies and that the alleged transport of the contaminated water constituted a "dispersal" of PCE from the contaminated well to the residents' homes. However, the court warned against adopting a literal reading of the pollution exclusion, noting that such an application would exclude coverage for acts remote from the ordinary understanding of pollution harms and unrelated to the concerns that gave rise to the exclusion. For example, the court raised the hypothetical scenario of a "tanker truck filled with PCE crashing into a bridge abutment, spilling its liquid cargo, causing another vehicle to skid on the wet surface of the highway into the abutment, injuring the driver." While PCE is a "contaminant" and caused the bodily injury in this scenario, the pollution exclusion was not intended to preclude coverage in a situation like this since "in no reasonable sense of the word 'pollution' was the driver a victim of pollution. . . . That the occurrence happens to be precipitated by a contaminant is incidental; its presence makes the risk or amount of loss no more uncertain than if, in the hypothetical, the tanker truck had spilled milk rather than PCE."

The court noted that the Illinois Supreme Court in *American States Ins. Co. v. Koloms,* 177 Ill. 2d 473 (1997), interpreted the pollution exclusion to be limited to harms arising from "traditional environmental pollution." However, in this case the Seventh Circuit stated that a "more perspicuous formula" would be "pollution harms as ordinarily understood." The court nonetheless rejected the insureds' argument that the pollution exclusion should only apply to clean-up costs. Rather, it held instead that while the current broad pollution exclusion was adopted from, among other things, the government-ordered cleanup costs imposed by the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), the "'predominate motivation' for excluding pollution coverage was 'avoidance of the enormous expense . . . of environmental litigation,' which is a broader class of litigation than just CERCLA actions, the pollution exclusion cannot be limited to clean-up costs."

Additionally, the court found irrelevant the insureds' notion that the exclusion did not apply because they did not originate the contamination. The exclusion precludes coverage for liability resulting from the "dispersal," "migration," or "release" of contaminants, "and is not limited to the creation or the first distribution of the pollutant." In this case, the contamination was confined to the groundwater drawn by the well. However, by distributing the water to the residents, the village caused the PCE to migrate throughout the village, resulting in personal injury and contamination. Accordingly, the court held that the coverage was precluded by the pollution exclusion, affirming the district court's grant of summary judgment.

Practice Note

The law in Illinois still does not provide a clear rule as to the application of the pollution exclusion. *See e.g., Connecticut Specialty Ins. Co. v. Loop Paper Recycling, Inc.,* 356 Ill. App. 3d 67, 82 (1st Dist. 2005) (finding a "we-know-it-when-we-see-it" standard is still not helpful). In sum, the test created by the Illinois Supreme Court in *Koloms* ("traditional environmental pollution") remains unclarified and, if anything, the Seventh Circuit has made this issue even less clear, by tendering its more "perspicuous formula"—"pollution harms as ordinarily understood." Courts and litigants will therefore continue to struggle with application of the *Koloms* test and may also need to address the new formulation by the Seventh Circuit.

Scottsdale Indemnity Company, et al. v. Village of Crestwood, et al., 2012 WL 769730 (7th Cir., Mar. 12, 2012)