A Third Option: A Battle over the Pollution Exclusion That You Didn't Know Existed

Andrew Paul Van Osselaer, Michael J Scanlon, and Erin McGuire

Aug 14, 2024 4 min read

Summary

- The Indiana rule may have far-reaching effects if *Chisolm* becomes the law of New Mexico.
- *Chisolm* may serve to further highlight the Indiana rule as a third option and rightfully encourage policyholders in those states to push for that rule's adoption.
- If this exclusion rule extends beyond Indiana, we may find insurers developing an entirely new pollution exclusion to address this third camp more broadly.

Thinkstock Images via Getty Images

It is generally accepted in the insurance field that there are two jurisdictional camps for interpreting the scope of pollution exclusions. The first camp interprets pollution exclusions only to exclude what is often described as "traditional environmental pollution"—e.g., contamination of the air, water, or land. [1] The second camp interprets pollution exclusions broadly to exclude potentially any injury arising out of the release of pollutants, contaminants, or irritants—not just those arising from traditionally understood pollution events.

Jurisdictions following the first approach base their reasoning on exclusions' clear and unambiguous language, in exclusions' inherent ambiguity, or in the reasonable expectations of the insured. [2] Advocates of the second approach, on the other hand, tend to base their interpretation solely on the exclusion's supposedly clear and unambiguous meaning—at least where it does not expressly limit itself to environmental harm (as some do). Advocates of this approach often tout it as being less variable in its application (and therefore supposedly more predicable), but it often leads to unusual results contrary to policyholder expectations. In one case, for example, coverage of damage to furs from the aroma of curry from a nearby restaurant was excluded because the aroma was considered a contaminant. [3] As another example, the Seventh Circuit explained that under such a broad interpretation, a pollution exclusion may exclude a slip-and-fall caused by spilled Drano because the accident was supposedly caused by the release of a pollutant. [4]

Indiana's Third Option

Unbeknownst to many, however, Indiana law provides a third option. The Indiana Supreme Court has rejected both of the above camps, instead finding the pollution exclusion to be per se ambiguous as to what it excludes when it refers merely to "pollutants," "contaminants," and "irritants" (and similarly less-than-descriptive terms). [5] As a result, in Indiana, insurers must specifically identify the substances that are excluded if their pollution exclusion is to have any effect at all. [6] That is to say, prototypical qualified, absolute, and total pollution exclusions are simply inoperative as written.

While critics of Indiana's rule have complained of it rendering pollution exclusions unworkable due to the level of specificity required, courts interpreting the Indiana rule have not taken the Indiana rule so far. While something more specific than "pollutant" is required, it need not be so specific as to require the identification of singular chemicals. [7] A sufficiently specific classification or even incorporation by reference (for example, of "Hazardous Substances" under the Comprehensive Environmental Response,

Compensation, and Liability Act) is likely sufficient. [8] The Seventh Circuit, for example, concluded that "petroleum or petroleum based substances" was sufficient to exclude gasoline. [9] Further, the Indiana approach is not inconsistent with those jurisdictions that understand pollution exclusions to apply only to traditional environmental contamination. They are guided by inherent ambiguity within standard pollution exclusions or policyholder expectations (or both), and both seek to resolve those issues in favor of coverage. The only difference is they take issue with different components of the exclusion, which make its scope unclear.

Indiana's Option May Be Spreading to Other States

Last year, Indiana's rule gained a following, presenting the possibility that what was once one state's unique path may now be a third (albeit smaller) camp unto itself. In *Chisolm's Village Plaza, LLC v. Travelers Commercial Insurance Co.*, the District of New Mexico made the *Erie* prediction that the New Mexico Supreme Court would likely follow a rule similar to Indiana's and held that a pollution exclusion was inoperative for failing to sufficiently define what substances are excluded. [10] The fate of that *Erie* prediction is now before the Tenth Circuit, with oral argument having taken place on May 20, 2024.

In *Chisolm*, the district court analyzed the two generally understood camps, which it dubbed the "literal" camp (referring to the expansive camp) and the "situational" camp (referring to the traditional pollution camp). The district court explained that the so-called "literal" approach leads to "absurd results," depriving policyholders of coverage in ways that could not have been intended. [11] It further noted that the New Mexico Supreme Court has in the past construed ambiguity strongly in favor of insureds, and the Tenth Circuit, applying Colorado law, has also recognized the "absurd results" created by the "literal" approach. [12] As for the situational approach, the district court concluded that New Mexico's supreme court would not tolerate a test that requires a case-by-case analysis—preferring a simple test that favors the insured. [13] In fact, if a case-by-case analysis is required, the court reasoned, that indicates ambiguity. [14]

If *Chisolm* is upheld, given certain practical aspects of diversity jurisdiction in New Mexico, that case is likely to become the de facto law of New Mexico. That is because insurance companies are rarely headquartered or incorporated in New Mexico, meaning diversity jurisdiction exists in the vast majority of insurance cases—in fact, practically all but the smallest, given amount-in-controversy requirements. [15] As a result, the New Mexico Supreme Court rarely has the opportunity to weigh in on federal courts' *Erie* predictions. Case in point, the last time the New Mexico Supreme Court addressed the pollution

exclusion in any form on any issue was 2012. [16] That being said, there remains the option for the Tenth Circuit to certify a question as to the New Mexico Supreme Court in *Chisolm*, which, if answered, would provide an unequivocal statement of New Mexico law.

If *Chisolm* becomes the law of New Mexico (either functionally or officially), the Indiana rule may have far-reaching effects. There are states where the law is not settled as to which camp they fall into. For example, Tennessee and Ohio (among others) lack a conclusive answer. [17] For that reason, *Chisolm* may serve to further highlight the Indiana rule as a third option and rightfully encourage policyholders in those states to push for that rule's adoption. Naturally, this would also put an even greater emphasis on choice of law in environmental and product pollution matters where New Mexico is a potential option. Finally, whereas now savvy insurers have rolled out Indiana endorsements to address coverage in Indiana, if this rule extends beyond Indiana, we may find insurers developing an entirely new pollution exclusion to address this third camp more broadly. [18]

Suffice it to say that before the Tenth Circuit is a fight over the future of the pollution exclusion few know to exist. And if the insured in *Chisolm* prevails, the implications may be far reaching.

Endnotes

1. *See MacKinnon v. Truck Ins. Exch.*, 73 P.3d 1205, 1209 (Cal. 2003).w

2. *See, e.g.*, *Apana v. TIG Ins. Co.*, 574 F.3d 679, 682–83 (9th Cir. 2009) (collecting cases with the situational approach).

3. *See Maxine Furs, Inc. v. Auto-Owners Ins. Co.*, 426 F. App'x 687, 688 (11th Cir. 2011) (per curiam).

4. *Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co.*, 976 F.2d 1037, 1043 (7th Cir. 1992). In *Pipefitters*, an employee of a company that bought a transformer from Pipefitters cut the transformer open, spilling 80 gallons of PCBs. 976 F.2d at 1038–39. The buyer of the transformer sued Pipefitters for the failure to warn. 976 F.2d at 1038–39. The court discussed the different interpretations of pollution exclusions but did not choose one because it found the spilling of 80 gallons of PCB would fit under the definition of pollution regardless of which interpretive approach the court adopted. 976 F.2d at 1043–44.

5. *See, e.g.*, *Am. States Ins. Co. v. Kiger*, 662 N.E.2d 945 (Ind. 1996).

6. *Compare Kiger*, 662 N.E.2d 945, *with W. Bend Mut. Ins. Co. v. U.S. Fid. & Guar. Co.*, 598 F.3d 918, 923–24 (7th Cir. 2010) (holding gasoline was excluded because policy specifically listed gasoline

as excluded).

7. *West Bend Mutual*, 598 F.3d at 923–24.

8. *West Bend Mutual*, 598 F.3d at 923–24.

9. *West Bend Mutual*, 598 F.3d at 923–24.

10. *Chisolm's Village Plaza, LLC v. Travelers Commercial Ins. Co.*, 621 F. Supp. 3d 1195, 1244–45 (D.N.M. 2022).

11. *Chisolm's Village Plaza*, 621 F. Supp. 3d at 1244–45.

12. *Reg'l Bank of Colo., N.A. v. St. Paul Fire & Marine Ins. Co.*, 35 F.3d 494, 498 (10th Cir. 1994) (quoting *Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co.*, 976 F.2d 1037, 1043 (7th Cir. 1992)).

13. *Chisolm's Village Plaza*, 621 F. Supp. 3d at 1246.

14. *Chisolm's Village Plaza*, 621 F. Supp. 3d at 1246.

15. Of course, there is the possibility the insurance company and insured are both headquartered or incorporated in the same state outside New Mexico.

16. *United Nuclear Corp. v. Allstate Ins. Co.*, 285 P.3d 644 (N.M. 2012).

17. *Philadelphia Indem. Ins. Co. v. Priority Pest Prot., LLC*, 398 F. Supp. 3d 280, 286 (M.D. Tenn. 2019) ("It appears that the scope of the pollution exclusion remains an unsettled question of Tennessee law."); *Admiral Ins. Co. v. Fire-Dex, LLC*, No. 1:22-CV-1087-PAB, 2022 WL 16552973, at *8 (N.D. Ohio Oct. 31, 2022) (holding that the issue of the pollution exclusion clause was unsettled in Ohio and therefore Ohio courts should decide the issue).

18. *See* Order on Plaintiff's Motion for Summary Judgement at 11–12, *St. Paul Fire & Marine Ins. Co. v. City of Kokomo*, No. 1:13-cv-01573-JMS-DML (S.D. Ind. June 25, 2015), ECF No. 134.

Authors

Andrew Paul Van Osselaer
Haynes and Boone LLP

...

Michael J Scanlon
Haynes and Boone LLP

...

American Bar Association
https://www.americanbar.org/groups/litigation/resources/newsletters/insurance-coverage/third-option-pollution-exclusion-battle/?login