

New Jersey Appellate Court Holds D&O Policy Pollution Exclusion Inapplicable

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A New Jersey intermediate court of appeals has held that the pollution exclusion in a D&O insurance policy did not bar coverage for a securities fraud action alleging that the insured corporation had misrepresented its contingent liabilities for asbestos-related claims retained by a spun-off subsidiary. *Sealed Air Corp. v. Royal Indem. Co.*, 2008 WL 3539964 (N.J. Super. Ct. App. Div. Aug. 15, 2008). The securities complaint alleged that the corporation knew the subsidiary would become insolvent once it was spun off but misrepresented in its financial statements that the subsidiary had retained all liability for asbestos-related claims. The securities complaint further alleged that the corporation's stock dropped substantially after the subsidiary became insolvent and the bankruptcy court agreed with a creditors' committee that the spin-off was a fraudulent conveyance.

In a declaratory judgment action brought by the corporation against the insurer, the court first noted that the insurer agreed that the securities action fell within the policy's Side C coverage. The court then examined the policy's pollution exclusion, which precluded coverage under that coverage part for any claim "based on, arising out of, or in any way involving a. the actual, alleged or threatened discharge, release, escape, seepage, migration or disposal of Pollutants into or on real or personal property, water, or the atmosphere; or b. any direction or request that the Company or the Insured Persons test for, detoxify or neutralize Pollution, or any voluntary decision to do so: including without limitation any Claim for financial loss to the Company, its security holders or its creditors based on, arising out of, or in any way involving the matters described in subparts a. or b. above." The court examined each phrase of the pollution exclusion's lead-in language and concluded that the provision could be interpreted to exclude claims "where a company's directors or officers were sued for pollution." However, the court found the connection between the allegations in the securities action against the corporation and the asbestos claims against the subsidiary to be too attenuated to trigger the exclusion. Noting that the securities action "arose from allegedly false and misleading representations and omissions pertaining to whether [the corporation] properly evaluated certain contingent liabilities regarding pollution liability claims" retained by the subsidiary, the court held that the pollution exclusion did not bar coverage because "the complaint clearly arises from alleged violations of the Securities Exchange Act of 1934 and the rules promulgated therefrom, not from intentional pollution."