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Addressing Pollution Exclusion in Virginia

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On April 20, 2012, the Supreme Court of Virginia, applying Virginia law, held that pollution exclusion endorsements in first-party property policies barred coverage for the insured's product losses caused by contamination of infant formula resulting from a manufacturing mishap. Policyholder advocates had unsuccessfully sought to limit the clauses to "traditional" outdoor pollution, *i.e.*, hazardous waste contamination.

In 2009, the policyholder - a manufacturer of infant formula - suffered loss when water filters in the formula heating system disintegrated and contaminated numerous batches of formula with melamine. The manufacturer sought insurance coverage from three carriers that had issued separate insurance policies for property damage and business interruption.

The carriers denied coverage, taking the position that the policies' pollution exclusion endorsements barred coverage. With minor variations, each policy's endorsement excluded coverage for "[l]oss or damage caused by, resulting from, contributed to or made worse by actual, alleged or threatened release, discharge, escape or dispersal of Contaminants or Pollutants ..."

"Contaminants or pollutants " included "any material which after its release can cause or threaten damage to human health or human welfare or cause or threaten damage, deterioration, loss of value, marketability or loss of use to property insured hereunder, including, but not limited to, bacteria, fungi, virus or hazardous substances ..."

After the parties commenced coverage litigation, the trial court ruled that the pollution endorsements excluded coverage for the claimed loss. *PBM Nutritionals LLC v. Lexington Insurance Co., et al.*, No.

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CL09-5289, 2011 Va. Cir. LEXIS 16 (Va. Cir. Ct. Jan. 7, 2011).

The manufacturer appealed.

Affirming the trial court, the Virginia Supreme Court first considered the manufacturer's position that the pollution exclusion contained in the manuscript form policy conflicted with the pollution exclusion endorsements. The manuscript pollution exclusion barred coverage for "loss or damage" caused by "the presence, release, discharge or dispersal of 'pollutants' unless the presence, release, discharge or dispersal is itself caused by a peril insured against."

Believing that the infant-formula loss fell within the exception to the manuscript pollution exclusion, the manufacturer argued that the manuscript pollution exclusion directly conflicted with the pollution exclusion endorsements.

However, the court concluded that even if the infant-formula loss fell within the exception, "[a]n exception that serves to negate the applicability of one particular exclusion does not create a 'conflict' with another policy exclusion that operates to bar coverage."

Because "[a]n exception to an exclusion does not create coverage where none exists," the court held that the terms of the manuscript pollution exclusion had no effect on the applicability of the pollution exclusion endorsements.

The court next turned to the manufacturer's argument that, even if the pollution exclusion endorsements applied, they were impermissibly overbroad. In the manufacturer's view, the endorsements should be limited "to traditional environmental losses."

The high court disagreed. Adopting an argument advanced by Wiley Rein LLP in an *amicus curiae* brief filed on behalf of the Complex Insurance Claims Litigation Association, the court reaffirmed that Virginia courts "will not insert by construction, for the benefit of a party, a term not express in the contract." Here, the pollution exclusion endorsements gave no indication that they were limited to "traditional" environmental pollution.

This decision makes clear that Virginia courts will apply to insurance policies the same even-handed contract interpretation rules applied to other contracts.

Further, it squarely rejects a key argument often made by policyholders, who contend that - notwithstanding their plain language - pollution exclusions should be limited to outdoor, hazardous waste contamination claims.