Pollution Exclusion Clauses
An Analysis of the Canadian Jurisprudence

By
Craig A.B. Ferris

June 19, 2008
These materials were prepared for the Canadian Institute's 8th Annual Conference on Litigating and Managing Insurance Coverage Disputes, held June 17-18, 2008 in Toronto, Ontario

POLLUTION EXCLUSION CLAUSES

An Analysis of the Canadian Jurisprudence[1]

[1] The author gratefully acknowledges and thanks Michael Snider and Heather M. Cane both of Lawson Lundell LLP for their assistance in the preparation of this paper.

TABLE OF CONTENTS

1. Introduction

This paper will address of a number of issues with respect to the pollution exclusion clauses commonly contained in Commercial General Liability ("CGL") insurance policies. In particular, this paper considers how Canadian courts have interpreted and applied the standard wording of pollution exclusion clauses, and whether the decision of the Ontario Court of Appeal in *Zurich Insurance Co. v. 686234 Ontario Ltd.*[2] ("*Zurich*") has had an effect on how subsequent courts have decided coverage disputes involving pollution exclusion clauses. Finally, in its conclusion, this paper summarizes the principles arising from the jurisprudence, in order to assist those faced with determining whether coverage is avoided by a pollution exclusion clause.

2. The standard form pollution exclusion clause: how has it evolved, and what does it look like today?

The historical development of the pollution exclusion clause contained in CGL policies has been thoroughly canvassed by a number of authors.[3] For the purposes of this paper, it is sufficient to note that the standard wording of the CGL pollution exclusion clause has changed considerably over the past 30 years. Initially, the clause provided that the exclusion would not apply in instances where the release of pollutants was "sudden and accidental" (the "Non-Absolute Clause"). The "sudden and accidental" exception spawned much litigation, and the pollution exclusion clause was subject to much judicial scrutiny in the United States.[4] As such, in 1985, the Insurance Services

---

[2] (2002) 62 O.R. (3d) 447 (C.A.), leave to appeal refused by 2003 S.C.C.A. No. 33

[3] See, Snowden & Lichty, *Annotated Commercial General Liability Policy* (Aurora: Canada Law Book, looseleaf) at 31:10; and G. Hilliker, *Liability Insurance Law in Canada*, 4th ed. (Markham: LexisNexis Butterworths, 2006) at 240-250.

[4] Snowden & Lichty, *supra* note 2 at 31:10.

Office[5] introduced the "absolute pollution exclusion" clause (the "Absolute Exclusion Clause"), which removed the "sudden and accidental" exception. The Absolute Exclusion Clause has become the standard form used in most CGL policies and provides as follows:

> This insurance does not apply to:
>
> 1. Pollution liability
>
> a. "Bodily injury" or "property damage" and "clean up costs" arising out of the actual, alleged, or threatened discharge, dispersal release or escape of pollutants:
>
> 1) At or from any premises, site or location which is or was at any time, owned or occupied by, or rented or loaned to an Insured;
>
> 2) At or from any premises, site or location which is or was at any time, used by or for any Insured or others for the handlings, storage, disposal processing or treatment of waste;
>
> 3) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for any Insured or any person or organization for whom the Insured may be legally responsible; or
>
> 4) At or from any premises, site or location on which any Insured or any contractors or subcontractors working directly or indirectly on any Insured's behalf are performing operations:
>
> a) if the pollutants are brought on or to the premises, site or location in connection with such operations by such Insured, contractor or subcontractor; or
>
> b) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify, or neutralize the pollutant.
>
> b. Any loss, cost, or expense arising out of any governmental direction or request that an insured test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.
>
> "Pollutants" means any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapour, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.
>
> Sub paragraphs 1) and 4)a) of paragraph a. of this exclusion do not apply to "bodily injury" or "property damage" caused by heat, smoke or fumes from a hostile fire. As used in this exclusion, a "hostile fire" means one which becomes uncontrollable or breaks out from where it was intended to be.

---

[5] The Insurance Services Office (http://www.iso.com) publishes standard form insurance policy provisions that are often adopted and integrated into policies offered by insurers.

The most recent form of the Absolute Exclusion Clause was drafted in 2005 by the Insurance Bureau of Canada. It provides the following:

> 4. Pollution
>
> (1) "Bodily injury", "property damage" or "personal and advertising injury" arising out of the actual, alleged or threatened spill, discharge, emission, dispersal, seepage, leakage, migration, release or escape of "pollutants":
>
> (a) At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, any insured. However, this subparagraph does not apply to:
>
> (i) "Bodily injury" if sustained within a building and caused by smoke, fumes, vapour or soot from equipment used to heat, cool or dehumidify the building, or equipment that is used to heat water for personal use, by the building's occupants or their guests;
>
> (ii) "Bodily injury" or "property damage" for which you may be held liable, if you are a contractor and the owner or lessee of such premises, site or location has been added to your policy as an additional insured with respect to your ongoing operations performed for that additional insured at that premises, site or location and such premises, site or location is not and never was owned or occupied by, or rented or loaned to, any insured, other than that additional insured; or
>
> (iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire";
>
> (b) At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage, disposal, processing or treatment of waste;
>
> (c) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for:
>
> (i) Any insured; or
>
> (ii) Any person or organization for whom you may be legally responsible; or
>
> (d) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the "pollutants" are brought on or to the premises, site or location in connection with such operations by such insured, contractor or subcontractor. However, this subparagraph does not apply to:
>
> (i) "Bodily injury" or "property damage" arising out of the escape of fuels, lubricants or other operating fluids which are needed to perform the normal electrical, hydraulic or mechanical functions necessary for the operation of mobile equipment or its parts, if such fuels, lubricants or other operating fluids escape from a vehicle part designed to hold, store or receive them. This exception does not apply if the "bodily injury" or "property damage" arises out of the intentional discharge, dispersal or release of the fuels, lubricants or other operating fluids, or if such fuels, lubricants or other operating fluids are brought on or to the premises, site or location with the intent that they be discharged, dispersed or released as part of the operations being performed by such insured, contractor or subcontractor;

(ii) "Bodily injury" or "property damage" sustained within a building and caused by the release of gases, fumes or vapours from materials brought into that building in connection with operations being performed by you or on your behalf by a contractor or subcontractor; or

(iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire".

(e) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants".

(2) Any loss, cost or expense arising out of any:

(a) Request, demand, order or statutory or regulatory requirement that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants"; or

(b) Claim or "action" by or on behalf of a governmental authority for "compensatory damages" because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of, "pollutants".

However, this Section (2) does not apply to liability for "compensatory damages" because of "property damage" that the insured would have in the absence of such request, demand, order or statutory or regulatory requirement, or such claim or "action" by or on behalf of a governmental authority.

The terms "pollutants" is defined as :

"Pollutants" mean any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, odour, vapour, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or re-claimed.

It should be noted that litigation may still arise where an application of the Non-Absolute Clause is at issue. However, given that almost all CGL policies issued since the 1985 version include the Absolute Exclusion Clause (or some minor variation of it), this paper will focus on the courts' interpretation of that incarnation of the pollution exclusion clause.

3. How have Canadian courts interpreted and applied the standard wording of the Absolute Exclusion Clause?

(a) Decisions before *Zurich*

The Absolute Exclusion Clause has been subject to a fair amount of litigation in Canada. The exclusion has allowed a number of insurers to avoid defending certain claims.[6] However, notwithstanding the fact that the intent of its drafters was to make the exclusion all-encompassing (hence "absolute"), some commentators have noted a recent trend in Canadian jurisprudence which suggests that courts will restrict its interpretation in certain contexts.[7]

In *Trafalgar Insurance Co. of Canada v. Imperial Oil Ltd.*[8] ("*Trafalgar*"), the Ontario Court of Appeal considered the application of the Absolute Exclusion Clause to a situation where the insured was hired to clean up an oil spill at a private home. The clean-up job was allegedly performed negligently and the homeowner brought a claim against the insured for damages. The insurer sought to deny coverage on the basis that it was precluded by the Absolute Exclusion Clause. The majority of the Court found that the Absolute Exclusion Clause did not operate in this case. At paragraph 72 of the majority decision, Feldman J.A. noted:

> In this case, the acts alleged to have been done by Hope occurred during the course of its clean-up of the already discharged oil. Hope was neither an active nor a passive polluter in respect of the original spill, for which it had no responsibility. Hope's alleged failure to remediate the situation in a timely manner constitutes an independent act, which occurred after the original discharge and therefore constituted an independent cause of the plaintiffs' loss. There is no claim made against Hope for damage caused by the original escape, nor could there be. The claim against Hope does not arise out of the original escape of the oil but out of its later action in failing to clean up the oil and prevent future damage beyond the

---

[6] See, for example, *Kellogg Canada Inc. v. Zurich Insurance Co.*, [1997] O.J. No. 3116 (Gen Div.); and *Pretty v. Ontario,* [2001] O.J. No. 4867 (S.C.J.). See, also, the discussion below of *Dave's K. & K. Sandblasting (1988) Ltd. v. Aviva Insurance Company of Canada,* 2007 BCSC 791; and *Attorney General of Quebec v. Girard*, [2004] Q.J. No. 13624 (QC C.A.).

[7] Snowden & Lichty, *supra* note 2 at 31:20.2(1).

[8] (2001) 57 O.R. (3d) 425 (C.A.).

> time when the situation should have been remediated. Therefore the damage allegedly caused by Hope's negligence does not arise out of the escape, discharge, dispersal or release of a pollutant as prescribed in the clause.

The Court in *Medicine Hat (City) v. Continental Casualty Co.*[9] *("Medicine Hat")* also interpreted the Absolute Exclusion Clause narrowly. In that case, the City of Medicine Hat was sued for allegedly exposing its bus system employees to certain chemicals. The City sought its insurer to defend the suit; the insurer attempted to deny coverage based on the operation of the Absolute Exclusion Clause. The Court found that the Absolute Exclusion Clause did not apply and that the insurer had a duty to defend the action. The Court based its decision on an analysis of the protection that the Absolute Exclusion Clause was intended to provide the insurer. At paragraph 27, the Court noted:

> "Discharge, dispersal, release or escape of pollutants" is the language of improper or unintended events or conduct. It is not the language of intended use or consequences or of the normal operation of facilities or vehicles. In this case, the polluting substance or gas is part of and confined to the intended and normal operation of a transit garage and buses. This conduct and these events do not fall within the exclusion clause. In my view, the pollution exclusion clause is intended to protect the insurer from liability for the enforcement of environmental laws. The exclusion clause uses environmental terms of art because it is intended to exclude coverage only as it relates to environmental pollution and the improper disposal or contamination of hazardous waste.

In *Great West Development Marine Corp. v. Canadian Surety Co.*,[10] ("*Great West*") the B.C. Supreme Court considered the case of a developer who was sued for allegedly dumping contaminated soil. The developer's insurer sought to rely on the Absolute Exclusion Clause to avoid having to defend the claim. In finding that the insurer had a duty to defend the developer, the Court adopted a very restrictive interpretation of "pollutant", and noted at paragraphs 26-27 that:

> The ingredients in the mix of excavated material in question might well *contaminate* topsoil but they are not necessarily *contaminants* in the abstract. The mix constituting the excavated material, for example, may well not qualify as an environmental pollutant.

---

[9] [2002] A.J. No. 350 (Q.B.), aff'd 13 C.C.L.I. (4th) 52 (C.A.).

[10] 2000 BCSC 806.

> It is unclear to me on the pleadings that the fill from the construction site could reasonably be considered a pollutant in the general sense of being harmful, or having in any significant quantity components or ingredients that might be thought inherently harmful, dangerous or of likely deleterious effect. [emphasis in original]

Canadian courts have exhibited an unwillingness to strictly apply the wording of the Absolute Exclusion Clause against the interests of insureds. Building on the foundation of this jurisprudence, in 2002, the Ontario Court of Appeal wrote what one author has called the "most comprehensive analysis to date"[11] of the Absolute Exclusion Clause in *Zurich*.

(b) The decision of the Ontario Court of Appeal in *Zurich*.

In *Zurich*, the insurer issued two commercial general liability insurance policies to a company that owned an apartment complex. The insured became subject to certain class action proceedings in which the plaintiffs alleged that they had suffered injuries from breathing carbon monoxide, which had leaked from a faulty furnace in the apartment complex. The insured looked to the insurer to defend and indemnify it with respect to the class action. The insurer applied for a declaratory judgment that it was not obliged to defend or indemnify the insured due to the operation of the Absolute Exclusion Clause in the insurance policy. The applications judge dismissed the insurer's application, and found that the Absolute Exclusion Clause was intended to vitiate coverage for injuries resulting from pollution of the natural environment, and not the indoor environment. The insurer appealed the decision.

The Ontario Court of Appeal affirmed the decision of the applications judge, and found that the insurer had a duty to defend the claims against the insured and to indemnify the insured for any damages caused by the carbon monoxide leak. In his decision, Borins, J.A., undertook a comprehensive analysis of the historical underpinnings of the pollution liability exclusion, and

---

[11] Hiliker, *supra* note 2 at 246

reviewed the relevant Canadian and American jurisprudence. At paragraphs 37 - 39 of the decision, Justice Borins noted:

> In my view, in construing contracts of insurance, dictionary literalism is often a poor substitute for connotative contextual construction. When the full panoply of insurance contract construction tools is brought to bear on the pollution exclusion, defective maintenance of a furnace giving rise to carbon monoxide poisoning, like related business torts such as temporarily strong odours produced by floor resurfacing or painting, fail the common sense test for determining what is "pollution". These represent claims long covered by CGL insurance policies. To apply an exclusion intended to bar coverage for claims arising from environmental pollution to carbon monoxide poisoning from a faulty furnace, is to deny the history of the exclusion, the purpose of CGL insurance, and the reasonable expectations of policyholders in acquiring the insurance.
>
> …
>
> … the history of the exclusion demonstrates that it would produce an unfair and unintended result to conclude, in the context of a CGL policy, that defective machinery maintenance constitutes "pollution", even when it gives rise to carbon monoxide poisoning…
>
> …
>
> Given that the exclusion is capable of more than one reasonable interpretation, it is ambiguous and should be interpreted in favour of the respondent. The historical context of the exclusion suggests that its purpose is to bar coverage for damages arising from environmental pollution, and not the circumstances of this case in which a faulty furnace resulted in a leak of carbon monoxide.

It should be noted that the Court in *Zurich* relied heavily on American jurisprudence in deciding the case before it. At paragraph 34 of *Zurich* the Court of Appeal noted that:

> Clearly, there have been more cases in the United States than in Canada that have considered the absolute pollution liability exclusion clause generally, and more specifically its application to carbon monoxide poisoning. The few Canadian cases that have dealt with the absolute pollution liability exclusion have not explored in depth its history and purpose. It is also evident that more academic commentary in the United States has considered this issue. As Hilliker notes at p. 32, where there is little or no Canadian authority on a point of insurance law, our courts have turned to American law for assistance. This is particularly so where the same provision, such as the absolute pollution liability exclusion in CGL policies, is in common use by the insurance industry in Canada and the United States and where the American authorities have applied rules of construction not materially different from our own.

It is beyond the scope of this paper to offer a comprehensive analysis on the state of the law in the United States with respect to pollution exclusion clauses. However, it should be noted that in *Zurich*,

the Court of Appeal stated at paragraph 15 that it relied in particular on the "leading" decision of the Illinois Supreme Court in *American States Insurance Co. v. Koloms*[12] (*"Koloms"*). The *Koloms* case, like the case in *Zurich*, involved carbon monoxide poisoning that resulted from a defective furnace. The Court in *Koloms* found that the pollution exclusion clause did not apply due to the fact that "the exclusion applies only to those injuries caused by traditional environmental pollution".[13] While the Court of Appeal in *Zurich* acknowledged that there is a line of American jurisprudence that adopts a more literal interpretation of the Absolute Exclusion Clause, it concluded that the *Koloms* line of cases was "more persuasive".[14]

(c) The aftermath of *Zurich*

It is no surprise that upon the release of the *Zurich* decision, many insurers worried that Canadian courts would take an even more restrictive view of the Absolute Exclusion Clause. The decision in *Zurich* has been cited in a number of cases; however, the majority of these cases cite *Zurich* with respect to general principles of insurance contract interpretation.[15] To date, only four decisions are meaningful applications of *Zurich* with respect to a consideration of a pollution exclusion clause. Three of these cases involved the Absolute Exclusion Clause, while one involved the application of a pollution exclusion clause in the context of a Directors and Officers ("D&O") liability policy. An analysis of these cases follows.

---

[12] (1997) 687 N.E.2d 72 (Ill. S.C.)

[13] Ibid.

[14] *Zurich*, *supra* note 1 at paragraph 37.

[15] For example, that contracts should be interpreted with a view toward the reasonable expectations of the parties, that ambiguous clauses should be interpreted in favour of the insured, and that American authorities should be consulted when courts are confronted with a dearth of Canadian case law

(i) *Palliser Regional (School) Division #26 v. Aviva Scottish & York Insurance Co. Limited*[16] ("*Palliser*")

In *Palliser,* the applicant Regional Division owned certain lands situated on a coal bed. Neighbouring residents commenced an action against the applicant, alleging that coal dust was being blown from the applicant's property onto their land. The applicant maintained an insurance policy with the respondent and requested that the respondent provide the applicant with a defence to the lawsuit brought by the neighbours. The respondent denied the applicant's request on the basis that the Absolute Exclusion Clause precluded coverage for the lawsuit advanced by the neighbours.

The Court in *Palliser* held that the respondent could not rely on the Absolute Exclusion Clause and had a duty to defend the applicant with respect to the lawsuit advanced by the neighbours. The Court found it particularly important that the pollution complained of did not result from the normal business activities of the applicant. The Court found the following at paragraphs 39 – 40:

> Here it is not within anyone's reasonable expectation in the circumstances that the operation of the school could or would result in the release or discharge of coal dust from the coal bed.
>
> …
>
> If an insured is involved in a business which could lead to or possibly lead to the pollution of the environment, then both the insurer and insured in taking out a comprehensive general liability insurance policy would direct their minds to the coverage sought, the risk involved and the probability of that risk. No insurer would take on that risk of pollution in a comprehensive general liability policy if the insured was involved in an industry with possible polluting side effects or byproducts. Hence the reason by the insurer to include in such a comprehensive general liability policy, an exclusion clause denying coverage for pollution. Instead in a case involving an insured possibly polluting the environment arising from its business activities, the insured could address its mind to the pollution risk and obtain a specific policy covering the risk of pollution without a pollution exclusion clause. Of course the premiums would increase in direct proportion to the higher incidence of pollution risk.

[16] 2004 ABQB 781

The Court in *Palliser* noted at paragraph 45 that it was "guided by the interpretive approach" set out in *Zurich*. The Court in *Palliser* then quoted extensively from *Zurich*, including paragraphs 37-39 noted above and concluded at paragraph 46 that:

> It is my view that the airborne coal dust is not industrial pollution or pollution to which the Pollution Exclusion clause should apply. The Pollution Exclusion clause is not directed at occurrences outside of those reasonably contemplated by the insurer and the insured arising from the operations and activity of the insured in operating the elementary school. The release of coal dust from the coal bed is not an occurrence to be expected or intended to be excluded from coverage.

(ii) *Hay Bay Genetics Inc. v. MacGregor Concrete Products (Beachburg) Ltd.*[17] ("*Hay Bay*")

In *Hay Bay*, the defendant delivered a septic tank to the plaintiff for the purpose of storing pig manure. The septic tank was faulty and leaked the manure, which contaminated the land. The plaintiff sued the defendant to recover the remediation costs; the defendant looked for coverage from its insurers. The insurers sought to rely on the Absolute Exclusion Clause to avoid coverage.

The Court in *Hay Bay* found that the Absolute Exclusion Clause did not apply; thus, the insurers had a duty to defend the defendant. The Court relied on the decision in *Zurich*, and noted at paragraph 30 that:

> [When] interpreting insurance policies, courts should ensure that the reasonable expectations of the parties are taken into account. Indeed, this has been the approach taken by some American courts, as highlighted by Mr. Justice Borins in Zurich Insurance Company v. 686234 Ontario Ltd., While one line of American cases adhere to a strict interpretation of the terms of the exclusion clause, other cases apply various interpretative approaches to identify the "real" expectations of the parties. In doing this, courts focus on the history of the exclusion clause, its environmental context and the purpose behind purchasing a CGL policy in the first place. [citation omitted]

The Court followed *Zurich* further, commencing at paragraph 37:

---

[17] (2003) 6 C.C.L.I. (4th) 218 (Ont. S.C.J.).

> Turning then to the pollution clause, on a literal interpretation, it can easily encompass an environmental pollution exception. "Waste" could cover just about every conceivable item. Even accepting that waste covers animal waste, particularly "pig manure", it is against the interests of justice to apply "hyperliterally" the terms of the exclusion clause without taking into account the specifics of this situation, as stated by Justice Borins in Zurich, supra at paras. 10 and 36. MacGregor would not have taken out this insurance coverage if it were not to cover potential pollution risks. Just as in the Zurich, supra, situation, MacGregor is not in the business of polluting the environment as a result of the nature of its business. Pollution may have been a risk, but it was not a probable consequence of carrying out its business. The pollution that occurred here was unplanned and could have occurred for a variety of reasons.
>
> If MacGregor is not an active industrial polluter and if the damage was caused as a result of pure accident or perhaps negligence, this would render an ambiguity in the exclusion clauses such that the insurance companies cannot invoke the protection of the pollution exception clause. Thus, the interpretation of this exclusion clause should be dealt with at trial on the basis of evidence presented by all parties

(iii) *Dave's K. & K. Sandblasting (1988) Ltd. v. Aviva Insurance Company of Canada*[18] ("*Sandblasting*")

In *Sandblasting,* the petitioner operated a sandblasting business on property it leased. When the lease terminated, the owner of the property undertook certain environmental testing and determined that the soil was contaminated. The owner sued the petitioner to recover the costs of remediating the property. The petitioner sought a declaration that the respondent was obliged under a policy of insurance to defend the action. The respondent argued that it had no obligation to defend the action as the claim was excluded by the Absolute Exclusion Clause.

The B.C. Supreme Court noted at paragraph 26 that pollution exclusion clauses "[have] been the subject of much litigation in the United States, less so in Canada". The Court went on to say that "*Zurich* notes that the courts have generally resisted insurers' attempts to apply the exclusion to situations not involving traditional environmental contamination".

The decision in *Sandblasting* then goes on to quote paragraphs 39-40 of *Palliser, supra.* However, notwithstanding the citation of both the *Zurich* and *Palliser* decisions, the Court in *Sandblasting*

---

[18] 2007 BCSC 791.

ultimately held that the claim fell within the pollution exclusion clause and as such, the respondent had no duty to defend the action against the petitioner. Critical to the Court's finding was the fact that unlike the insured in *Palliser,* the petitioner in *Sandblasting* was "involved in business activities that could lead to the pollution of the environment".[19] The Court elaborated on this point at paragraph 30:

> The allegation against K&K is that it spread over the Relocated Sandblasting Site mounds of used sandblasting residue that contained concentrations of antimony and chromium. That claim falls directly under the terms of the pollution exclusion and is not covered by the insurance policy.

(iv) *Boliden Ltd. v. Liberty Mutual Insurance Co.*[20] ("*Boliden*")

In *Boliden*, the plaintiff mining company was insured by the defendant. A mining disaster in Spain caused a mine owned by a subsidiary of the plaintiff to be contaminated with toxic waste. The value of the shares in the publicly traded plaintiff dropped rapidly, and certain shareholders commenced a class action alleging the plaintiff misrepresented certain claims with respect to the Spanish mine in its prospectus. The plaintiff looked to the defendant to defend the claim by the shareholders. The defendant denied coverage based on the operation of a pollution exclusion clause.

The Court in *Boliden* acknowledged that the fact situation before it made the case novel. At paragraph 1 of the decision, the Court noted: "this is the first case in Canada dealing with the application of a pollution exclusion clause in a D&O policy in the context of securities litigation against directors and officers".

The plaintiff in *Boliden* relied heavily on the decision in *Zurich;* however, at paragraph 20 of its decision, the Court distinguished the application of *Zurich*:

---

[19] *Sandblasting, supra* at paragraph 28.

> It is evident that [in *Zurich*] Borins J.A. was influenced by the historical evolution of the pollution clause and the fact that if it were interpreted as the insurer wished, there would be little left for coverage of the insured's business. That is different from this case. There is no evidence before me of any history of the pollution clause in question. More importantly, the D&O policy covers a broad range of wrongful acts and a misrepresentation case involving underlying pollution problems would be but one of many claims that could fall within the policy. Even for pollution losses, the exclusion loss for pollution losses does not apply to defence costs incurred in relation to a pollution loss claim made in a derivative action against directors and officers if that coverage is specified in a separate endorsement. I accept, however, that if there were an ambiguity such as would lead to more than one compelling interpretation, the language of Borins J.A. would lead to the clause being construed against the insurer.

Ultimately, the Court based its decision on a comprehensive analysis of how the term "pollution loss" operated in the context of the plaintiff's claims. The Court found at paragraph 36 that some of the allegations of misrepresentation contained in the shareholders' statement of claim involved pollution, while others did not. Based on the operation of a certain endorsement to the policy, the insurer was obligated to pay 80% of the defence costs of the plaintiff since the pollution exclusion clause applied to some, but not to all, of the claims.

(v) Other post-*Zurich* pollution exclusion cases

In addition to the above noted cases that specifically reference the decision in *Zurich*, it should be noted that a number of post-*Zurich* decisions have considered the application of pollution exclusion clauses without referring to the decision in *Zurich*.

In *Tux and Tails Ltd. v. Saskatchewan Government Insurance*,[21] the plaintiff shipped certain clothing inventory by truck and trailer. While en-route, a container of a highly odorous gas was punctured by another piece of freight and contaminated the clothing. The plaintiff sought to be reimbursed by the defendant under a policy insuring the damaged clothing. The defendant argued that a pollution

---

[20] (2007) 85 O.R. (3d) 492 (S.C.J.)

[21] 2003 SKQB 287

exclusion clause applied and thus the damage was not covered under the policy. The Court found that the pollution exclusion clause did not apply because the escape of the pollutant was directly caused by a peril that was not excluded by the policy.

In *Attorney General of Quebec v. Girard*,[22] the Court found that based on a "clear pollution exclusion clause", the insurer had no duty to defend the portion of claims that were advanced with respect to pollution related-injuries

Finally, in *Harvey's Oil v. Lombard General Ins.*[23] ("*Harvey's*"), the Court considered whether the defendant insurer had a duty to defend the plaintiff against claims resulting from the plaintiff's delivery of fuel oil to leaking fuel supply systems. The court concluded that the insurer could not rely on the Absolute Exclusion Clause for two main reasons. First, the Court found that the mere delivery of a potential pollutant to the premises from which it ultimately escaped could not be considered "performing operations" under the Absolute Exclusion Clause. Second, the Court found that the delivery of the fuel oil could not be regarded as bringing the pollutant to the premises under the Absolute Exclusion Clause.

While the Court in *Harvey's* made no reference to the decision in *Zurich*, it should be noted that the Court did take into consideration the reasonable expectations of the parties, in much the same way that the Ontario Court of Appeal did in *Zurich*. At paragraph 54 the Court noted:

> I do not accept that Harvey's and Lombard intended to exclude coverage for one of the most significant risks in the major area of Harvey's operations. A reasonable construction of the language of the Lombard Policy does not require the denial of coverage.

---

[22] [2004] Q.J. No. 13624 (QC C.A.)

[23] 2003 NLSCTD 158

4. Conclusion on the aftermath of *Zurich* and general principles to be gleaned from the pollution exclusion clause jurisprudence

It appears that the courts have adopted the decision in *Zurich* when faced with similar fact situations and have utilized the Ontario Court of Appeal's "connotative contextual construction" approach to analyzing the Absolute Exclusion Clause. It is also important to note that even in cases such as *Boliden* and *Sandblasting*, which distinguished *Zurich*, the cases were distinguished on their specific facts. The courts did not question the principles espoused in *Zurich* and they remain good law.

It will likely take several more years to amass a body of jurisprudence rich enough to truly assess the impact of the *Zurich* decision. Nonetheless, Canadian courts have articulated the following principles that insurers and their legal counsel would be wise to keep in mind when considering whether coverage is triggered or may be denied under a pollution exclusion clause:

- Coverage cannot be avoided under the Absolute Exclusion Clause if the cause of action relates to an independent act that arises following the polluting event (*Trafalgar*);
- Pollution exclusion clauses are intended to protect the insurer from liability for the enforcement of environmental laws (*Medicine Hat*);
- Merely because a material may act to contaminate another material, does not make it a contaminant in the abstract (*Great West*);
- In construing contracts of insurance, courts will likely avoid interpretation based on "dictionary literalism" or "hyperliteralism" and will likely interpret exclusion clauses with a "connotative contextual construction" that takes into account the specifics of the situation (*Zurich; Hay Bay*);
- The Absolute Exclusion Clause is ambiguous and should be interpreted in favour of the respondent (*Zurich*);
- Courts will consider the reasonable expectations of policyholders when determining whether the Absolute Exclusion Clause applies (*Zurich*; *Palliser*; *Hay Bay*; *Harvey's*);
- Coverage is more likely to be legitimately denied under the Absolute Exclusion Clause if the pollution results from the normal business activities of the insured (*Palliser; Hay Bay; Sandblasting*); and

- The Absolute Exclusion Clause likely operates to only bar coverage for damages arising from environmental pollution, not the pollution of indoor spaces (*Zurich*).

Vancouver
1600 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada V6C 3L2
Telephone 604.685.3456
Facsimile 604.669.1620

Calgary
3700, 205-5th Avenue SW
Bow Valley Square 2
Calgary, Alberta
Canada T2P 2V7
Telephone 403.269.6900
Facsimile 403.269.9494

Yellowknife
P.O. Box 818
200, 4915 – 48 Street
YK Centre East
Yellowknife, Northwest Territories
Canada X1A 2N6
Telephone 867.669.5500
Toll Free 1.888.465.7608
Facsimile 867.920.2206

genmail@lawsonlundell.com
www.lawsonlundell.com