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Recent Developments in Canadian Insurance Coverage Litigation: Consideration of Selected Issues

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Introduction

Past opening remarks at Canadian insurance coverage conferences by the authors have often reflected a perceived dearth of coverage law in Canada relative to that south of the border. We frequently noted that in respect of certain important issues, coverage practitioners were left to speculate about what approach Canadian courts would take in respect of a specific issue. However, we also noted that Canadian coverage lawyers have been able to anticipate solutions to emerging issues, by reviewing United States and to a lesser extent Commonwealth developments. Times are changing. A considerable volume of Canadian coverage jurisprudence has emerged. As well, coverage issues more frequently arise for the first time in Canadian courtrooms.

One factor driving the increase in coverage litigation is the globalized nature of business. Canadian policyholders are expanding their risk exposure in all parts of the globe. Global companies, particularly resource companies, are expanding their operations in Canada. It is to be expected that Canadian insurers are facing the novel coverage questions or complex issues of the type their counterparts in the United States, the United Kingdom and the rest of the world experience.

We have included in this paper a discussion of cross-border coverage issues which have arisen in the past number of years. The *Pope & Talbot* litigation in British Columbia has demonstrated the emerging interplay between both the business but also coverage law in Canadian and American jurisdictions. The series of cases demonstrate the manner in which insurance

companies must accommodate differing legal regimes. We also address developing, but still unsettled, case law from the U.S. Supreme Court in respect of when Canadian companies (and their insurers) will be subject to the jurisdiction of American courts.

We then review a notable development in the law respecting invasions of privacy from the Ontario Court of Appeal, and its coverage implications. The *Jones v. Tsige* litigation recognizes a "new" broadly structured tort - "Intrusion upon Seclusion". The new tort constitutes a significant expansion in the law's ability to compensate individuals for unwarranted intrusions into their private affairs. The elements of the tort set out in *Jones* closely mirror a broadening of privacy torts in the *Restatement (Second) of Torts* in the United States in 2010. It appears that the development of this area of law will be contemporaneous in both countries and the myriad legal jurisdictions in each. We then explore the emerging coverage implications for insurers arising from the tort(s) of privacy invasion.

We start, however, with an area of coverage litigation which has retained vitality over the course of decades: pollution exclusions. The active versus passive polluter distinction has been considered and sometimes differently treated by Canadian courts. Other interpretative principles have been enunciated. However, the law continues to evolve. The Ontario Court of Appeal recently issued its judgment in *ING Insurance Co. of Canada v. Miracle (c.o.b. Mohawk Imperial Sales)*, which denotes a move away from the passive versus active dichotomy. We consider this and another recent case from Ontario.

I. MIRACLE AND THE POLLUTION EXCLUSION[1]

1. INTRODUCTION

On April 26, 2011, the Ontario Court of Appeal released its decision in *ING Insurance Co. of Canada v.Miracle (c.o.b. Mohawk Imperial Sales)*.[2] Overturning the lower court decision, the Court of Appeal enforced a pollution liability exclusion, thereby upholding the insurer's coverage denial under a Commercial General Liability policy.

North American courts have adopted a restrictive approach to application of the pollution exclusion. By way of example, the Ontario Court of Appeal decision in *Zurich Insurance Co. v. 686234 Ontario Ltd.*, determined that "dictionary literalism" should be rejected in favour of a "connotative contextual construction" approach when interpreting the exclusion.[3] Rather than applying dictionary meaning of policy terms to the underlying facts/allegations, the court preferred a "common sense test for determining what is pollution".[4]

A review of American and Canadian coverage jurisprudence prior to *Miracle* discloses the adoption by courts of a number of practices and principles, in addition to "connotative contextual construction", which have had the effect of limiting the application of the pollution exclusion in a number of loss scenarios. One such interpretative technique has been the tendency to limit the exclusion to industrial-type business activity of the insured. Another approach was to treat the exclusion as precluding coverage in respect of "active" polluters only. In other words, the

passive polluter who inadvertently permits the escape of a pollutant was not caught by the pollution exclusion. In contrast the polluter directly responsible for discharge of a pollutant as part of its business activity was caught by the exclusion.

Does the appellate decision in *Miracle* represent a return to a more literal interpretation of the language of the pollution exclusion? *Miracle*, at a minimum, may represent a step away from a trend to a marked restrictive interpretation and application of this exclusion.

In *Miracle*, the Court of Appeal clearly rejected application of this exclusion based on the supposed distinction between the "active" versus "passive" polluter. Both active and passive polluters are said to be subject, in certain factual circumstances, to application of the pollution exclusion. On the other hand, the Court of Appeal appears to continue to advocate the "connotative contextual construction" approach advocated in *Zurich*. A hyper-literal interpretative approach is not to be adopted. Judicial interpretation of "context" continues.

Whether the industrial-type business activity restriction will continue to apply to limit the reach of the pollution exclusion is unclear. The Court of Appeal did not expressly address this doctrine in *Miracle*. However, the underlying claim arose out of a fuel leak at a commercial gas bar. Loss involved a typical leaky storage tank claim. The underlying claim arose from business-related business activity of the insured. Accordingly, the holding in *Miracle* is consistent with continued application of the industrial-type business activity principle but the reasons of the Court of Appeal do not necessarily advocate such limitation.

(A) PRE-MIRACLE

Before considering the *Miracle* decision and its impact, a brief review of the key cases is in order.

In *Zurich*, the policyholder owned an apartment building in which the furnace leaked carbon monoxide. Two proposed class actions were brought alleging carbon monoxide poisoning and negligence on the insured's part for failure to maintain and properly inspect the furnace. The Ontario Court of Appeal held that the pollution exclusion contained in the CGL insurance policies at issue did not apply. The insurer had a duty to defend and indemnify.

In so finding, the Court of Appeal reviewed the history of the absolute pollution exclusion. It concluded that the exclusion was intended to eliminate coverage for the cost of government-ordered clean up under legislation making industry responsible for its pollution of the natural environment. The Court of Appeal quoted, with approval, U.S. case law to the effect that the exclusion applies only to traditional industrial environmental pollution. Reference was also made to the Court of Appeal's refusal, in the past, to enforce a clear and unambiguous exclusion clause where to do so would be inconsistent with the main purpose of the insurance coverage and contrary to the reasonable expectations of an ordinary person as to the coverage purchased.

The critical reasoning of the Court of Appeal in denying the application of the pollution exclusion in *Zurich* is contained in two paragraphs of the judgment. Both the industrial-type business activity restriction and the active versus passive polluter dichotomy are evident therein. Borins J.A. wrote:

There is nothing in this case to suggest that the respondent's regular business activities place it in the category of an active industrial polluter of the natural environment. Put simply, the respondent did not discharge or release carbon monoxide from its furnace as a manufacturer discharges effluent, overheated water, spent fuel and the like into the natural environment. It was discharged or released as a result of the negligence alleged in the underlying claims, which remains to be proved. As I have pointed out, 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. In this regard, it is necessary to understand that the exclusion focuses on the act of pollution, rather than the resulting personal injury or property damage.

Accepting for the purpose of my conclusion that carbon monoxide is a "pollutant" within the meaning of the exclusion, although it is arguably clear in its plain and ordinary meaning, the exclusion is overly broad and subject to more than one compelling interpretation, as is evident from its construction by American courts. 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. Based on the coverage provided by a CGL policy, a reasonable policyholder would expect that the policy insured the very risk that occurred in this case. A reasonable policyholder would, therefore, have understood the clause to exclude coverage for damage caused by certain forms of industrial pollution, but not damages caused by the leakage of carbon monoxide from a faulty furnace. In my view, the policy provisions should be construed to give effect to the purpose for which the policy was acquired.

The Ontario Superior Court of Justice followed *Zurich* in *Hay Bay Genetics Inc. v.MacGregor Concrete Products (Beachburg) Ltd*.[5] In the latter case, the insured was a subcontractor who supplied and installed a concrete tank for the storage of pig manure on a hog production farm. The tank leaked and the farm operator was ordered by Environment Canada to clean up the resultant environmental damage. The farm operator commenced an action against the insured. The policyholder was insured under two CGL policies. Both insurers denied coverage on the basis of total pollution exclusion clauses. The court denied application of the clauses and ordered both insurers to defend.

Like the Court of Appeal in *Zurich*, the Superior Court of Justice took a contextual approach to the exclusion rather than simply applying its terms literally to the facts before it. The Superior Court of Justice accepted the intent of the pollution exclusion to be avoidance of the enormous exposure presented by increased environmental litigation. The court picked up and expanded upon the active v. passive polluter dichotomy. The passive polluter who inadvertently permits

the escape of pollutants but is not directly responsible for same was not caught by the pollution exclusion. The court also relied upon the industrial-type activity restriction. In the case before it, the insured was not in the business of polluting the environment as a result of the nature of its business. In other words, it was not an active industrial polluter.

Sheffield J. wrote:

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.[6]

The Alberta Court of Queen’s Bench adopted the Ontario Court of Appeal’s interpretive approach to the pollution exclusion from *Zurich* in *Palliser Regional School Division No. 26 v. Aviva Scottish & York Insurance Co.*[7] In *Palliser*, the insured acquired ownership of land on which there was an inactive coal bed covered by soil and vegetation. The insured operated a school on the land. Through no fault of the insured, the coal bed became exposed and coal dust was blown onto an adjacent subdivision. An action was commenced on behalf of some residents alleging damage to property and persons. The court found the pollution exclusion in a comprehensive liability insurance policy did not negate the insurer’s duty to defend the underlying action.

Reliance was placed on the passive v. active polluter dichotomy as well as the industry-related business activity restriction by the court. It was emphasized that the insured did not cause the alleged pollution as a result of its business activities. The coal dust was not created nor was it permitted to escape as part of the insured’s business activities in operating a school. There was no connection between the insured’s business activities and the coal dust. Park J. wrote, “[i]t is my view that the airborne coal dust is not industrial pollution or pollution to which the Pollution Exclusion clause should apply.” The court also noted that the coal bed was not exposed nor was the coal dust released by any direct action on the insured’s part. The Alberta Court of Queen’s Bench disagreed with an earlier decision of the Ontario Court of Appeal in *Ontario v.*

Kansa General Insurance Co. in which any attempt to distinguish between active and passive polluters was rejected.[8]

B.C. courts have engaged the passive versus active debate. The prime example is Justice Goepel's decision in *Dave's K. & K. Sandblasting (1988) Ltd. (c.o.b. K&K Sandblasting Ltd.) v. Aviva Insurance Co. of Canada*, where-in the British Columbia Supreme Court held that the pollution exclusion precluded coverage.[9] In that case, the policyholder carried on a sandblasting business on leased premises. The sandblasting residue stored on the property resulted in unacceptable concentrations of antimony and chromium in the soil. The lessor was required to clean up the property. It sued the policyholder for the cost of remediation. The policyholder sought coverage from Aviva. Aviva relied on a pollution exclusion clause within its CGL policy. The British Columbia Supreme Court agreed that the pollution exclusion clause precluded coverage.

The court determined that the insured's direct business activities caused contamination to the outdoor environment. Applying the principles developed in various cases, inclusive of *Palliser* and *Zurich*, it determined that the exclusion had application in such circumstances. In other words, the insured was an active industrial polluter.

B.C. Courts have also demonstrated a willingness to apply pollution exclusions in first party policies, wherein the insured is not a business directed at contaminating the environment. Acknowledging that Justice Sigurdson's judgment in *Corbould v. BCAA Insurance* 2010 BCSC 1536 was addressing a pollution exclusion in a property policy, not CGL, the decision nevertheless suggests that while the active versus passive polluter distinction retains vitality in British Columbia, it may receive a very narrow application. Sigurdson J. wrote at paragraph 95 of his reasons:

I do not see in the language or the surrounding circumstances an ambiguity in the insurance coverage as it relates to this particular incident. I do not find that the case at bar is similar to *Palliser*. The finding in *Palliser* was that the coal dust was in no way related to the activities of the insured in the operation of a school. Is there a similar type of ambiguity that could be said to exist here? In the case at bar, Mr. Corbould obviously intended to bring the heating oil onto his property and would use it to heat his home. I am also unable to find an ambiguity like that found in Zurich where the court found it to be ambiguous because the exclusion there focused on the act of pollution rather than the resulting personal injury or property damage and because the historical context of the exclusion suggests that its purpose was to bar coverage for environmental pollution, not a faulty furnace that resulted in a leak of carbon monoxide.

It would seem in B.C., pleas of "reasonable expectations" and assertions of the insured's status as a "passive" polluter cannot generally be employed to overcome clear language in the policy.

(B) MIRACLE

This brings us to the recent Ontario Court of Appeal decision in *Miracle*. The insured operated a self-service gas bar. Gasoline leaked from an underground storage tank on the insured's property and contaminated adjacent lands. The adjacent property owner brought an action against the insured seeking damages for loss of property value, the costs of conducting an environmental assessment and the costs of clean up. The claim was advanced in nuisance, negligence and strict liability. The pleading specifically relied upon environmental protection statutes. The CGL carrier brought an application seeking a declaration that it had no duty to defend or indemnify the insured on the basis of the pollution exclusion in the policy.

The wording of the "Pollution Liability Exclusion" at issue was typical. It provided that the insurance did not apply to:

2. Pollution Liability

a. "Bodily injury" or "property damage" or "personal injury" or "advertising liability" arising out of the actual, alleged, potential or threatened spill, discharge, emission, dispersal, seepage, leakage, migration, release or escape of pollutants:

…

(2) 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;

…

(5) 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 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, decontaminate, stabilize, remediate or neutralize, or in any way respond to, or assess the effect of the pollutants.

b. Any fines or penalties assessed against or imposed upon any Insured arising out of the actual, alleged, potential or threatened spill, discharge, emission, dispersal, seepage, leakage, migration, release or escape of pollutants.

c. Any loss, cost or expense arising out of any request, demand or order that any Insured or others test for, monitor, clean up, remove, contain, treat, detoxify, decontaminate, stabilize, remediate or neutralize or in any way respond to, or assess the effect of pollutants unless such loss, cost or expense is consequent upon "bodily injury" or "property damage" covered by this policy.

d. “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.

The Ontario Superior Court of Justice held the pollution exclusion not to apply. The lower court reasoned that the insured did not release the gas into the environment as a result of its regular business activities. It was not an industrial polluter. Rather, it was alleged in the underlying action that the insured was negligent in allowing the gasoline to escape from its tank. In essence, the insured was characterized as a passive, non-industrial polluter.

The Court of Appeal allowed the appeal. No duty to defend or indemnify was found to be owed by the insurer. In so holding, the Court of Appeal expressly held that the *Zurich* decision could not be read to restrict application of the CGL pollution exclusion to the conduct of “active industrial polluters” only. Rather, the Court of Appeal confined the *Zurich* case to its particular facts. R.J. Sharpe J.A. wrote:

... *Zurich* must be read in the context of the specific issue the court was addressing. Borins J.A. rejected what he quite appropriately described as a “hyperliteral” argument that the claim was excluded because it arose from the “escape” of “gas”. The court refused to accept the insurer’s strictly literal interpretation of the clause in favour of one that determined the meaning and reach of the exclusion, given its historical purpose and a common sense assessment of the insured’s business activity. The exclusion’s ordinary meaning in those circumstances was found to be ambiguous and contrary to the insured’s reasonable expectations.

The facts before the court in Miracle were distinguishable. The activity of the insured, namely, underground storage of gasoline for resale at a gas bar, carried with it an “obvious” and “well-known” risk of pollution and environmental harm. This activity was held to fall squarely and unambiguously within the language of the pollution exclusion.

R.J. Sharpe J.A. reasoned:

Unlike *Zurich*, in this case, the insured was engaged in an activity that carries an obvious and well-known risk of pollution and environmental damage: running a gas station. Indeed, the statement of claim is framed as a claim for damage to the natural environment caused by a form of pollution. While the respondent Canada now attempts to characterize its claim as if it primarily, if not exclusively, sounds in negligence, that ignores the fact that the statement of claim asserts the causes of action commonly associated with pollution-based claims for environmental damage: strict liability (presumably on the basis of *Rylands v. Fletcher* (1868), L.R. 3 H.L. 330) and nuisance as well as negligence. The negligence claim is based in part upon alleged breaches of both provincial and federal environmental legislation and regulation. The damages claimed are for harm to the environment: the loss of property value due to contamination of the soil, the cost of investigating, testing and monitoring the contamination caused by the migration of a hazardous product from the lands of the insured, and the cost of rectifying the contamination and remediating the plaintiff’s property. Such a claim fits entirely within the

historical purpose of the pollution exclusion, which was "to preclude coverage for the cost of government-mandated environmental cleanup under existing and emerging legislation making polluters responsible for damage to the natural environment": See *Zurich*, at para. 13.

The Court of Appeal went on to reject the active v. passive polluter distinction. Reliance was placed on *Kansa*. *Kansa* is continued authority for the proposition that the pollution exclusion applies to the passive polluter who permits pollution to occur and the active polluter who discharges or causes the discharge of the pollution was confirmed.

The Ontario Court of Appeal decision in *Miracle*, therefore, appears to mark a return to application of this exclusion in circumstances in which the policyholder's activity has contributed to the escape, discharge, etc. of known pollutants. The decision in some respects restores underwriters' intent to preclude coverage, under the CGL policy, for loss attributable to recognized pollution harm, whether caused by active or passive conduct.

(C) POST-MIRACLE

Miracle restores previous Ontario authority finding that the distinction between an "active" and "passive" polluter is not relevant to the exclusion analysis. The "active" element in the "active industrial polluter" restriction has been eliminated. Query, however, whether the "industrial polluter" requirement survives? Based on *Miracle*, the pollution exclusion applies where the insured is engaged in an activity that carries with it a known risk of environmental harm. Running a gas station is such an activity. It also, however, happens to be a business if not an industrial activity. By its very nature, the insured's business carried with it a risk of pollution. Query whether, post-*Miracle*, there will remain a tendency by the courts to limit application of the pollution exclusion to industrial or business activity of the insured.

Post-*Miracle*, the pollution exclusion still would not apply to circumstances in which a furnace in an apartment building operated by the insured leaks carbon monoxide. *Zurich* was distinguished in *Miracle*. *Zurich* was not overturned. A number of insurers have recognized and accepted this limitation. They have placed an exception within the pollution exclusion which precludes application of this clause to escape of deleterious substances from internal heating and related sources.

The question is whether a case like *Hamelin v. Commercial Union Assurance Co.*, for example, would be decided differently today.[10] In *Hamelin*, approximately 800 litres of heating oil escaped from a rupture to an outside storage tank on the insured's commercial premises. The owners and occupiers of the abutting residential lands sought recovery for contamination of their water supply in the underlying action. The court held that a rider exclusion relating to the escape of pollutants was not a bar to the insurer's duty to defend or indemnify.

The Ontario Court of Justice, General Division reasoned that the intent of the exclusion was "to deal with pollutants actually applied or which were a part of the business activity of the insured".

The fuel oil which leaked was used to heat the insured's premises as opposed to being used as part of the insured's business activity. Therefore, the pollution exclusion did not apply.

In light of *Miracle*, characterization of the insured in *Hamelin* as a passive polluter is no longer relevant to application of the pollution exclusion. Rather the question becomes whether the polluting activity arises from a well-known risk associated with the insured's business. While storage of oil in a tank on one's premises carries with it a well-known risk of environmental harm should the tank leak, the leakage of oil used to heat an insured general contractor's premises is not a known risk of the industry-related business activity of the insured. Storage of fuel oil in these circumstances is not an industrial-type business activity.

The Ontario Superior Court of Justice recently had occasion to revisit application of the pollution exclusion, but with the benefit of the Court of Appeal's guida