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PUBLICATION

MIRACLE - Is It What Insurers Have Been Waiting For?

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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)*.[1] Over turning the lower court decision, the Court of Appeal enforced a pollution liability exclusion, thereby, negating coverage under a Commercial General Liability policy.

In the past, the courts have taken a somewhat surprisingly, restrictive approach to application of the pollution exclusion. Beginning with the Ontario Court of Appeal decision in *Zurich Insurance Co v 686234 Ontario Ltd*, generally, "dictionary literalism" has been rejected in favour of a "connotative contextual construction" approach when applying the exclusion.[2] Rather than super imposing the claims made in the underlying pleadings on the particular wording of a pollution exclusion, the courts have preferred a "common sense test for determining what is 'pollution'".[3]

A review of Canadian coverage jurisprudence prior to *Miracle* reveals the adoption by the courts of a number of practices/principles which have the effect of limiting the application of the pollution exclusion. One such practice is the tendency to limit the exclusion to industrial-type business activity of the insured. Another is 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 is not caught by the pollution exclusion where as the active polluter directly responsible for discharge of a pollutant as part of its business activity is caught by the exclusion.

Does the appellate decision in *Miracle* signify restoration of the intent of the pollution exclusion? *Miracle*, at a minimum, appears to mark a step toward restoring the scope of the exclusion intended by insurers and their underwriters.

In *Miracle*, the Court of Appeal clearly rejects the “active” v. “passive” polluter distinction. Both active and passive polluters are said to be caught by the pollution exclusion. On the other hand, the Court of Appeal appears to leave the contextual approach advocated in *Zurich* undisturbed. A hyperliteral approach is not suggested.

Whether or not 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 have to deal with the principle in *Miracle*. The underlying claim arose out of a fuel leak at a commercial gas bar. It was your typical leaky storage tank claim and resulted from industry- 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.

PRE-MIRACLE

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

In *Zurich*, the policy holder 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 and 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, withapproval, 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 v. passive polluter dichotomy are evident there in. 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 policy holder would expect that the policy insured the very risk that occurred in this case. A reasonable policy holder 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*.[4] 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 policy holder was insured under two CGL policies. Both insurers denied coverage on the basis of the 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.[5]

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.*[6] 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 on to 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 directaction 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.[7]

There are past cases in which a Canadian court has enforced the pollution exclusion clause in a CGL policy. For example, in*Dave's K. & K. Sandblasting (1988) Ltd (c.o.b. K & K Sandblasting Ltd) v Aviva Insurance Co of Canada,* the British Columbia Supreme Court applied a pollution exclusion to preclude coverage.[8] In that case, the policy holder carried on a sandblasting business on leased premises. The sandblasting residuec 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 policy holder for the cost of remediation. The policy holder 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 to whom application of the pollution exclusion in previous cases had generally been limited.

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 cleanup. 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 particular 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, cleanup, 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 itstank. 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 owed by the insurer. In so holding, the Court of Appeal expressly rejected that the effect of the *Zurich* decision is to restrict application of the CGL pollution exclusion to “active industrial polluters”. 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 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*'s 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 an expansion of the circumstances in which the pollution exclusion will be held to apply. It should go some way in restoring the intent of the pollution exclusion under the CGL policy.

POST-MIRACLE

There is no question that *Miracle* restores previous Ontario authority holding that the distinction between an "active" and "passive" polluter is not relevant. 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 an industrial-type business activity. By its very nature, the insured's business carried with it a risk of pollution. Whether, post-*Miracle*, there will remain a tendency by the courts to limit application of the pollution exclusion to industrial-type business activity of the insured remains to be seen.

Post-*Miracle*, the pollution exclusion 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.

The question is whether a case like *Hamelin v Commercial Union Assurance Co*, for example, would be decided differently today.[9] 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. If an industrial-type business activity restriction continues to apply after *Miracle*, it is probable that the pollution exclusion would still not negate coverage. 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.

CONCLUSION

Only time will tell whether the Ontario Court of Appeal decision in *Miracle* is the decision insurers have been waiting for, namely, a case restoring the reach of the pollution exclusion in a CGL policy to that intended by its drafters.

Prior to *Miracle*, the courts tended to limit application of the pollution exclusion to "active" polluters despite the absence of language in the exclusion itself distinguishing between active and passive pollution. The Court of Appeal in *Miracle* refused to read in such a distinction. Both active and passive polluters are caught by the pollution exclusion.

Prior to *Miracle*, there has been a tendency to restrict application of the exclusion to industrial-type business activity of the insured. The Court of Appeal in *Miracle* held the exclusion to apply where the insured was engaged in a business activity carrying a well-known risk of pollution: running a gas station. Whether, the courts will continue to limit application of the exclusion to industry-related business activity of the insured, albeit industry-related activity carrying a well-known risk of environmental harm, remains to be seen.

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1 *ING Insurance Co of Canada v Miracle (c.o.b. Mohawk Imperial Sales*, 2011 ONCA 321, [2011] OJ no 1837 (QL) [*Miracle*].

2 *Zurich Insurance Co v 686234 Ontario Ltd* (2002), 62OR (3d)447, 222DLR (4th) 655, [2002] OJno4496 (QL), leave to appeal to SCC refused, [2003] SCCA no 33 (QL) [*Zurich*].

3 *Ibid.*

4 (2003), 6 CCLI (4th) 218, [2003] OJ no 2049 (QL).

5 In its reasons, the Ontario Superior Court of Justice held that the reasonable expectations of the parties ought to be taken into account when interpreting the pollution exclusion even where the exclusion is clear and unambiguous. An exclusion should not be enforced where to do so would defeat the main purpose of obtaining insurance. Note that the Supreme Court of British Columbia was critical of this proposition in *Corbould v BCAA Insurance Corp*, 2010 BCSC 1536,

90 CCLI (4th) 257, [2010] BCJ no 2125 (QL). There, the court held that the reasonable expectations doctrine is an interpretative tool to be applied only in the event of ambiguity in the policy. Like *Miracle*, *Corbould* arguably signals a more inclusive approach to the pollution exclusion. A pollution exclusion under an all-risks property policy was held to negate coverage for a property damage claim arising out of a fuel oil leak from an above-ground storage tank. The spill of oil into the soil was held to meet the common sense definition of pollution. If the exclusion was not read to catch a heating oil tank leak on the insured's residential property, then what was it intended to catch? The oil was being stored for home-heating as opposed to business purposes. Unlike under a CGL policy, however, an industrial-type business activity restriction could not be read in. The policy at issue was a residential property policy. Accordingly, this B.C. case may not be as prophetic with respect to future treatment of the pollution exclusion under a CGL policy as one might first assume.

6 *Palliser Regional School Division No.26 v. Aviva Scottish & York Insurance Co*, 2004 ABQB 781, 370 AR294, 18 CCLI (4th) 98, [2004] AJ no 1356 (QL) [*Palliser*].

7 *Ontario v. Kansa General Insurance Co* (1994), 17 OR (3d) 38, 111 DLR (4th) 757, [1994] ILR 2719, [1994] OJ no 177 (CA) [*Kansa*], leave to appeal to SCC refused,[1994] SCCA no 123. Under Ontario law, the passive polluter permitting pollution to occur was just as much a polluter as the active polluter who discharged the pollution.

8 2007 BCSC 791, 51 CCLI (4th) 229, [2008] 2 WWR 163, [2007] BCJ no 1203 (QL).