Court Interprets Pollution Exclusion Narrowly In Asbestos Misrepresentation Case

A federal district judge in Kalamazoo has held that a pollution exclusion in a liability insurance policy does not prevent insurance coverage for a claim by an asbestos removal contractor against an insured property owner, where the direct cause of the claim was an alleged misrepresentation by the insured owner concerning the quantity of asbestos to be removed, rather than the removal of the asbestos itself.

The Lansing Board of Water and Light (LBWL) needed to remove and dispose of asbestos located in its Ottawa Station. It asked asbestos removal contractors to submit bids on the project, and supplied drawings of the plant and other information for bidders to use in preparing their bids. LBWL awarded the asbestos removal contract to SCS Group, L.C. (SCS), which then subcontracted some of the work to Performance Abatement Services, Inc. (PAS).

After PAS began work on the project, it discovered that there was substantially more asbestos to be removed than it had estimated based on the drawings that LBWL had provided. PAS sued LBWL and SCS, claiming that LBLW had misrepresented the true quantity of asbestos to be removed, and that as a result PAS removed and disposed of a substantial quantity of asbestos without receiving additional contract payments. PAS claimed, among other things, that LBWL had misrepresented the facts upon which bidders were asked to provide bids.

Deerfield Insurance Co. (Deerfield), which had issued a liability insurance policy to LBWL, defended LBWL against the claim by PAS, but reserved its rights to claim that its policy did not cover the PAS claim. Deerfield paid $1.8 million to PAS to settle the PAS litigation.

Anticipating that Deerfield would deny coverage and ask LBWL to reimburse the $1.8 million, LBWL sued Deerfield in federal court seeking a declaratory judgment that the Deerfield

insurance policy covered the PAS claim. Deerfield asked the court to rule that the pollution exclusion in the policy, which excluded coverage for "any claim arising out of any . . . removal . . . of . . . contaminants or pollutants," prevented coverage of the PAS claim. Deerfield argued that the pollution exclusion applied because the PAS litigation involved LBWL's liability for removal and disposal of asbestos. LBWL argued that the PAS litigation involved alleged misrepresentation of facts leading to a contract cost overrun, and that asbestos was simply the subject of the contract. LBWL argued that the claim did not "arise out of" the removal of asbestos, but arose out of an alleged misrepresentation.

The court agreed with LBWL, finding that the case was very similar to the facts in *Owens-Corning v. National Union Fire Ins. Co.*, 1998 WL 774109 (6th Cir. 1998). In that case, shareholders of Owens-Corning alleged that company officials had misrepresented the company's financial exposure to asbestos claims. The United States Court of Appeals for the Sixth Circuit, applying Ohio law, held that Owens-Corning's liability insurer had a duty to defend the shareholder lawsuit, notwithstanding a pollution exclusion clause, because the shareholder lawsuit did not "arise out of" asbestos, but arose out of alleged misrepresentations by the company. The Sixth Circuit held that the words "arising out of" mean that there must be a close causal connection between the underlying claim and an insured event.

Relying on the *Owens-Corning* case, the judge held that the asbestos at LBWL's Ottawa Station was "too distant a cause of the underlying claim" against LBWL for that claim to have "arisen out of" asbestos, and that "the *immediate* cause of the claim was alleged misrepresentation." (Emphasis in original.) Therefore, the court held that the pollution exclusion did not prevent coverage of LBWL's claim.

The court distinguished a recent decision by the Michigan Court of Appeals, *McKusick v. Travelers Indemnity Co.*, in which that court had held that a pollution exclusion prevented coverage for an accident in which a hose being used by the insured to deliver chemicals broke and sprayed chemicals on the employees of its customer. In *McKusick*, the actual release of the chemicals was the direct cause of the injuries to the employees, while in LBWL's case, the alleged misrepresentation was the direct cause of the injury to PAS.

Lansing Board of Water and Light v. Deerfield Ins. Co., W.D. Mich., No. 5:00-CV-131 (Feb. 6, 2002).

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