

***From the Editor:  
BLACKOUTS RAISE  
COVERAGE ISSUES***

**A**s we went to press with this issue, the massive power blackouts that struck the East Coast, Midwest and parts of Ontario caused businesses, big and small, to shut down. If your business was affected, check your insurance policies for coverage and make claims now. Business-interruption coverage is a standard part of commercial property insurance and should cover losses from August's black-outs. General liability insurance should cover claims for injury or damage and may cover damage to computer data and assets. If you have questions, we advise you to consult a coverage attorney.

This issue also addresses other important coverage issues. Our first article discusses two recent high-court decisions limiting the reach of so-called absolute and total pollution exclusions to true "industrial" pollution.

The second article addresses the arbitration of insurance coverage disputes under "Bermuda form" policies. We hope you find these articles of interest.

Lorie Masters

***AN "ABSOLUTE" TREND: D.C. and  
New York Courts Limit the "Absolute  
Pollution Exclusion"***

by Susan C. Levy and Lorelie S. Masters

**I**n seeking approval for the "absolute pollution exclusion" in the mid-1980s, the insurance industry confronted questions about the breadth of their proposed exclusion. Insurance regulators expressed concern that the proposed exclusion could be read literally to exclude coverage in an array of situations that did not involve pollution at all. The insurance industry's representatives assured regulators that "no one would read it that way." History has proven that representation false.

In the late 1980s, courts almost uniformly held, regardless of the factual situation, that "absolute" meant "absolute." However, in part because of the insurance industry's over-reaching and its representations to regulators in the 1980s, today, two-thirds of the state appellate and supreme courts that have addressed the issue have limited the exclusion to its intended reach (at least as insurers represented it to state insurance commissioners) – true "industrial" pollution. In June and early July 2003, the District of Columbia Court of Appeals, D.C.'s highest court, and the New York Court of Appeals, New York's highest court, became the most recent state appellate courts to join this trend. Both found that the

The standard "absolute pollution clause" ("APC") typically excludes coverage for bodily injury or property damage "arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants," which is defined as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste . . . ."



**Susan C. Levy**



**Lorelie S. Masters**

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exclusion should be limited to its intended reach – precluding coverage only in those cases involving true environmental pollution. In addition, in another development as this issue went to press, the *California Supreme Court in MacKinnon v. Truck Insurance Co.*, No. S104543 (Cal. Aug. 14, 2003), reached the same conclusion in a case involving bodily injury from use of pesticides.

## **The D.C. Court of Appeals' Decision**

In *Richardson v. Nationwide Mutual Insurance Co.*, No. 0-SP-1451, 2003 D.C. App. LEXIS 418 (June 12, 2003), the D.C. Court of Appeals reversed a lower court's decision which had relieved Nationwide of its duty to defend and indemnify a policyholder for serious personal injuries, including brain damage suffered as a result of exposure to carbon monoxide leaking from a faulty gas furnace. Nationwide had sued the policyholder, National REO Management, in the United States District Court for the District of Columbia seeking a declaratory judgment that its general liability insurance did not apply to cover the injuries resulting from failure to properly maintain the furnace.

Answering a certified question regarding the scope of the pollution clause, the court considered whether the standard "absolute pollution clause" ("APC") found in most comprehensive general liability ("CGL") policies applied to the

policyholder's claim. The APC excludes coverage for bodily injury or property damage "arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants," which is

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**. . .the clause did not apply because its intended purpose was to preclude coverage for traditional environmental pollution that was the subject of federal and state environmental laws.**

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defined as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste . . ."

The district court granted summary judgment in favor of the insurer, concluding that the pollution exclusion barred coverage as a matter of law. On appeal, a majority of the three-member panel disagreed, holding that the clause did not apply because its intended purpose was to preclude coverage for traditional environmental pollution that was the subject of federal and state environmental laws.

In reaching its decision, the majority recognized that the courts are sharply divided regarding the meaning of the

exclusion. However, the majority "rejected the purportedly literal approach" of some courts and aligned itself with the trend holding that the clause should apply only to traditional "environmental" pollution. The court chose to read the exclusion "in context," in light of the historical circumstances in which the clause was drafted. The court found that the clause was drafted in response to and used the same terminology as the Comprehensive Environmental Response, Compensation & Liability Act ("CERCLA" or "Superfund"), 42 U.S.C. § 9601, and other federal and state environmental statutes and regulations. The panel therefore concluded, "The exclusion should not reflexively be applied to accidents arising during the course of normal business activities" simply because they involved a "discharge, dispersal, release or escape" of an "irritant or contaminant." The court therefore held that the case before it fell outside the exclusion because it did not involve the kind of situation for which the exclusion was designed.

In a lengthy, impassioned dissent, one judge found that carbon monoxide fumes constitute "pollutants" because they are "gaseous" "contaminants" which includes "fumes." The dissent criticized the majority for looking to the history of the exclusion when, in the dissenting judge's view, the language of the clause was "plain and unambiguous."

### The New York Court of Appeals' Decision

Like the court in *Richardson*, the New York Court of Appeals found that the "total pollution exclusion" is ambiguous when applied to a claim for bodily injury from inhalation of paint or solvent fumes. *Belt Painting Corp. v. TIG Ins. Co.*, No. 86, 2003 N.Y. LEXIS 1745 (July 1, 2003). Relying on two early decisions rejecting pollution exclusions in the context of asbestos bodily injury and lead-paint poisoning, the New York court reaffirmed that "the purpose of the exclusion was to deal with broadly dispersed environmental pollution."

The court in *Belt Painting* found that the exclusion "does not clearly and unambiguously exclude a personal injury claim from indoor exposure to a plaintiff-insured's tools of its trade." The court found that the "drifting" of paint fumes did not meet the "environmental implications" of the terms, "discharge, dispersal, seepage, migration, release or escape" of "pollutants," required by the APC. The court was "reluctant to adopt an interpretation that would infinitely enlarge the scope of the term 'pollutants,' and seemingly contradict both a 'common speech' understanding of the relevant terms and the reasonable expectations of a business person."

### Conclusion

Both cases support efforts by policyholders to enforce CGL insurance when an insurance

## SERVICE TO THE ABA

### Jenner Attorneys' Service in the ABA

Lorie Masters ends her term as Chair of the Insurance Coverage Litigation Committee of the American Bar Association's Section of Litigation in August. In March, Lorie, with co-chair Walter Andrews, presided over the Committee's 15th Anniversary celebration in Tucson, Arizona. At a celebratory dinner on March 7, 2003, the Committee recognized the service of its Founders and Chairs, which include Jenner & Block partner John H. Mathias, Jr., a founder and former Chair of the Committee.

Incoming Chair of the Section, Patricia Lee Refo, has selected Jenner partner Tim Burns, former chair of the Committee's Midyear Meeting and Managing Editor of the Committee's journal *Coverage*, to succeed Lorie as the policyholder Chair of the Committee.



Founders and Chairs of the Insurance Coverage Litigation Committee (left to right; Jenner partners in bold):

Front row – Carole Bos, George Kenny, **Lorie Masters**  
Back row – Walter Andrews, **John Mathias**, Mike Henke, Bill Campbell, Hon. Brooke Jackson, and Bob Saylor.

company seeks to exclude coverage for claims that involve something other than traditional environmental pollution. As shown by *Belt Painting* and other Appellate Division decisions, the New York courts have limited pollution clauses in a variety of factual contexts. Thus, although policyholders historically have considered New York law unfriendly, particularly when addressing the pollution exclusion, *Belt Painting* and other

recent decisions bring New York into accord with the majority of state appellate courts that have rejected the insurance industry's attempts to apply the exclusion far beyond its intended reach. The *Richardson* decision may also be relevant in any matter that involves the construction of a statute or contract, where the language must be read in context in order to give it the meaning that the drafters intended. •

## A FOREIGN EXPERIENCE:

### *Arbitrating Insurance Coverage Disputes in London*

by Lorelie S. Masters\*

**M**any insurance policies now include arbitration provisions providing that disputes be arbitrated in London under the substantive law of New York. To policyholders, the “deck” in an international insurance arbitration appears to be stacked in favor of the insurance company, if only because the insurance company – a repeat player in London arbitrations – knows the results of its past arbitrations and the policyholder (and its counsel) likely does not. However, with careful strategy and preparation, a policyholder can prevail even in a “foreign experience” in international insurance arbitration.

The policy form that began the London arbitration trend is the “Bermuda form” sold by companies like ACE Insurance Company, Ltd., and XL Insurance Company, Ltd. Except for a brief time when some Bermuda insurance policies required arbitration in Bermuda, the Bermuda form, since its inception in the mid-1980s, has included a London arbitration provision. Although, for many years, most disputes arising under the Bermuda form were settled, insurance disputes arising under the Bermuda form increasingly, in our experience, are arbitrated, either because Bermuda insurers, like insurers of yore, decide to litigate disputes or because the policyholder is unable to obtain redress (or even a response) otherwise.

Unlike arbitration of other disputes, arbitration of insurance disputes is not necessarily a cheaper or less expensive means of resolving disputes than litigation. Arbitration clauses in insurance policies are written by insurance companies, for the benefit of insurance companies. Arbitration in London requires “setting up shop” in London where many policyholders do not

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**...with careful strategy and preparation, a policyholder can prevail even in a “foreign experience” in international insurance arbitration.**

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have operations and putting up witnesses in an expensive (though interesting) capital of foreign arbitration. In addition, in large losses, policyholders may find themselves in a series of arbitrations, forced to engage in one proceeding after another to go up the “chain” of insurance companies, with the attendant risk of inconsistent litigation results and increased cost.

Arbitration, particularly in a foreign jurisdiction, can also spring traps for the unwary. At a minimum, American lawyers unschooled in the art of

international arbitration may find the procedures confusing, calling, as they do, for strategic decisions that differ from those that might be taken in traditional litigation before an American jury. However, policyholders can navigate these waters – and beat the insurance companies, who are repeat litigants in London arbitrations, at their own game.

#### **Selecting the Arbitrators**

The arbitration clause in a typical Bermuda form policy is as interesting for what it does not say as for what it does. For example, the clause gives little clue as to the considerations that go into the all-important process of selecting arbitrators. Under the clause, each party picks its own arbitrator. In part because the Bermuda form requires application of New York substantive law, some of the most strategic decisions of the arbitration are made at this stage, before the proceeding really begins. For example, should the policyholder select an American lawyer or jurist, who is schooled in the American federal system and, ideally, principles of New York insurance law? Should the policyholder select an experienced practitioner in the area of insurance coverage litigation or a retired judge?

A traditional English viewpoint is that policyholders should select a well-respected English barrister, called a Queen’s Counsel or Q.C. The argument is that, because the

\* Ms. Masters was lead trial counsel for a policyholder that recently prevailed in a London arbitration under the Bermuda form.

other two arbitrators on the panel likely will also be Q.C.s, it is important for policyholders to appoint another member of this select "club."

While this view holds great currency, policyholders are well-advised, in our view, to consider "de-Anglicizing" the arbitration panel by selecting an American arbitrator. A retired judge with expertise in New York law and the American judicial system can provide to the other arbitrators important insight on the issues of New York substantive law presented in the proceeding.

Although it is true that experienced English barristers are well-equipped to read and analyze American cases, English lawyers (including English arbitrators) are less likely to understand distinctions among American state and federal courts and the weight that should be accorded to their respective decisions. English lawyers therefore are less likely to fully appreciate the authoritative-ness of an unreported New York state trial decision versus a well-reasoned decision by the United States Court of Appeals for the Second Circuit, applying New York law. They also may not appreciate the importance of legislative history or other features of legal analysis taken more for granted on this side of the Atlantic. In situations where the New York Court of Appeals has not addressed an issue that is key in the arbitration, it is our judgment that the policyholder may be well-served by having an arbitrator in the hearing room who

## INSURANCE UPDATE

### **Environmental Cleanups Now Are Covered "Damages" in Wisconsin**

In July 2003, the Wisconsin Supreme Court overturned its anti-coverage rulings in *City of Edgerton v. General Casualty Co.* Instead, in *Johnson Controls, Inc. v. Employers Insurance of Wausau*, Wisconsin's high court ruled that the policyholder reasonably expected the insurer to defend when the policyholder received a "PRP letter." The court in *Johnson Controls* also joined the overwhelming majority of courts that have rejected an "overly technical definition" of the standard-form (and undefined) term, "as damages," found in CGL insurance policies. The court held that *Edgerton* conflicts with the language in the standard CGL policies and the policyholder's reasonable expectation of coverage. In reversing *Edgerton*, the court concluded that its earlier decision had created "an unworkable interpretation" of the insurer's policy obligations:

*Today the problems created by the Edgerton decision have become so obvious and so acute that they cannot be ignored . . . . [W]e did not correctly analyze the term "damages" in the standard CGL policy in relation to environmental cleanup costs under CERCLA . . . . We also created an unworkable interpretation of the insurer's duty to defend in the specialized context of CERCLA letters and orders.*

can speak authoritatively about these distinctions.

Once the parties have appointed their arbitrators, the two arbitrators select a Chair, or "neutral," for the panel. To minimize potential controversy and speed the proceedings, the parties may seek to agree on the choice of a Chair. Because arbitration is a process that proceeds more smoothly when the parties are able to reach consensus, the two party-appointed arbitrators in our experience are happy to abide by the parties' choice of a proposed Chair.

This choice of the Chair of the Tribunal also is important. The Chair should be an experienced arbitrator with the stature to command the respect of both the two party-appointed arbitrators and the parties themselves. Experience and force of personality also are factors to consider. An ideal Chair will ensure that the proceedings run smoothly, yet fairly for both parties, and will be completed in the shortest amount of time possible to ensure fairness to both parties.

## Initiating Arbitration

Either party may initiate the arbitration, simply by submitting a letter to the other side stating its desire to resolve a dispute by arbitration and invoking the arbitration clause in the insurance policy. As in litigation in a United States court, the policyholder typically is best-served when the process takes place in as short an amount of time as possible. First, an insurance company is most likely to consider serious settlement overtures when a trial date is looming. Second, at a minimum, expense for both parties likely will be minimized if the process takes place in a shorter, rather than a longer, time period. It is also true that insurance companies “play the float” – the longer the process takes, the longer the insurer gets to hold, and make interest on, the money.

In initiating arbitration, a policyholder may help expedite proceedings by naming its arbitrator in the arbitration demand, as stated in the arbitration clause. Doing so will activate the insurance company’s obligation to name its party-appointed arbitrator within 30 days. As a practical matter, the insurance company may seek an extension. However, the sooner the policyholder names its arbitrator, the sooner the proceedings will begin in earnest.

What advantages are to be gained by initiating arbitration? The primary advantage is that available to the plaintiff in a United States court: The ability to open the case and submit rebuttal after

the respondent’s case is presented. This advantage may carry over into pretrial hearings where the plaintiff is entitled to proceed first.

## New York Law

Bermuda-based insurance companies have drafted their policy form to apply (for the most part) the substantive law of New York in the belief that New York law tends to favor insurance companies. As shown by the recent decision by the New York Court of Appeals rejecting application of the “total pollution exclusion” in *Belt Painting v. TIG Insurance Co.*, that assumption does not always hold true. The policyholder should seek to exploit those provisions of New York law that may favor policyholders over insurance companies.

For example, misrepresentation and fraudulent nondisclosure are common defenses to a

policyholder’s claim for coverage. However, the New York statute applicable to these defenses may be used to require the insurance company to produce underwriting manuals and other documents that can discredit the insurance company’s argument that any alleged misrepresentation or omission was material.

In addition, as masters of the policy form, insurers have sought to jettison those parts of New York law they consider odious, like *contra proferentem*. Commentators have questioned whether this “gerrymandering” of the law is legitimate, but English lawyers have evinced little sympathy for this view.

## Discovery

In international arbitration, the parties may decide upon an agreed set of rules to govern discovery. Discovery, or “disclosure” as it is called in the

## TACTICS

Insurance companies often ask courts to vacate pro-policyholder rulings after settling with policyholders. The wisdom and propriety of vacatur in this situation have been subjects of debate, and a number of courts have refused to grant motions seeking such vacatur. For example, the court in *United Technologies Corp. v. American Home Assurance Co.* (“UT”) recently rejected the insurer’s motion to vacate jury findings, and the court’s punitive damage award punishing the insurer for violations of Connecticut’s Unfair Trade Practices and Unfair Insurance Practices Acts. Relying on the United States Supreme Court’s ruling in *U.S. Bancorp Mortgage Corp. v. Bonner Mall Partnership*, the court in *UT* concluded, “Rulings issued by the Court are not assets of the parties, free to be disposed of when no longer needed.” Policyholders may wish to consider this issue in negotiating settlement terms.

United Kingdom, includes only production of documents. Depositions are not permitted under the English procedural rules that govern an arbitration under the Bermuda form, and the insurance company is unlikely to agree to depositions – if only because the insurer would consider such discovery impermissible “parol evidence.” While English practice does not allow deposition discovery, it may require production of the transcripts of depositions taken in United States proceedings of potential witnesses that a party wishes to present at the arbitration. Production of deposition transcripts from American proceedings will allow the opposing party to cross-examine witnesses with potentially conflicting testimony.

Although rules governing disclosure have been relaxed in England in recent years, the traditional practice, which requires parties to set forth with specificity the categories of documents sought, continues. However, as in United States civil procedure, parties may move to compel disclosure if the opposing party refuses or fails to produce documents. This motion practice parallels that familiar to American lawyers. Parties identify disputed categories of documents, brief those issues for the Tribunal, and argue them at a hearing set for that purpose. The Tribunal then issues a decision on the disputed categories.

It may be important – indeed, crucial – for counsel for parties

under these procedural rules to continue to contest the opposing party’s failure to produce important categories of documents. Failure to do so may result in a finding by the Tribunal that the requesting party has waived its right to pursue production. Under English procedure, however, parties frequently pursue litigation on disputed categories of documents right through the actual trial. While the Tribunal will be reluctant to order additional production in mid-trial, it may do so in order to ensure the fairness of the proceedings. Presenting a written record confirming the requesting party’s diligence in seeking the discovery is important to success in these situations.

### **Counsel**

In the British system, lawyers have been traditionally either solicitors or barristers. Solicitors traditionally have prepared the case for trial, while barristers act as trial lawyers. Parties need not pursue the traditional English “model” in international arbitrations. For example, a United States law firm can act as the “solicitor” instructing a barrister or Q.C. at the final trial, or “hearing.” Alternatively, American lawyers may act as trial counsel or split those duties with an English solicitor or barrister. In our experience, it is helpful to have the advice and expertise of an English barrister or Q.C. in at least preparing the case for trial. The decision on whether to retain a barrister to help with

presentations at trial may depend on several factors, including cost, the composition of the Tribunal, and the lead trial lawyer for the insurance company.

An English lawyer can advise a policyholder’s trial team on the differences between American and English practice. For example, oral arguments made in closings after an arbitration trial differ from the advocacy taught to United States lawyers. In insurance arbitrations, policy-interpretation issues often figure prominently. Resolution of those issues may turn largely or even exclusively on principles of New York substantive law, as required under the Bermuda form. In English arbitrations, the practice is to lead the arbitrators, step by step, through the important authorities supporting an argument, with copies of the decisions in hand over the course of lengthy (by American standards) opening and closing arguments. This practice often seems odd to American lawyers. However, an effective English-style presentation of substantive legal principles may help decide the case in your favor.

### **Briefing**

Advice from an English lawyer is helpful in preparing the trial brief and bundles, or trial exhibits. The English style of briefing does not focus on case discussions to the extent common in American-style briefing. In part, this is because counsel discuss key authorities with the Tribunal at length during opening and closing arguments.

Because witness statements and oral evidence focus on disputed factual issues, the key place to discuss disputed issues of policy interpretation is in the trial briefing. In addition, because several months may pass between the completion of the trial or hearing and the arbitrators' final decisions in preparation of the Award, it is important that the trial brief contain a clear analysis of the policyholder's position on interpretation of disputed policy provisions.

Trial exhibits are presented in two-hole English binders (called "bundles") prepared and submitted to the Tribunal in advance of the start of the trial. The trial bundles include copies of pleadings and transcripts of earlier hearings in the matter, fact documents or trial exhibits, witness statements, authorities cited in the trial briefing, and policy documents. It is helpful if each trial bundle is indexed and organized in chronological order. Each document also is given a unique number keyed to the bundle in which it appears.

In our experience, as in American trials, the assistance of an experienced legal assistant can

be invaluable. A party's legal assistant can assist not only the parties' lawyers and witnesses, helping to locate trial exhibits in the bundle during cross-examination and oral argument, but also the Tribunal in organizing and finding documents. Having an arbitrator come to rely upon the expertise of your legal assistant, in preference to that of the opposing party, helps to project that aura of competence and thorough preparation that trial lawyers, American or British, seek to project.

#### **Trial**

The presentation of evidence in a London arbitration differs substantially from traditional trial practice in the United States, a fact that affects trial strategy and witness preparation. A party's direct or affirmative evidence is presented in writing in witness statements. Witnesses are presented live only for purposes of cross-examination.

A party should offer all of its witnesses for cross-examination or risk the chance that the arbitrators will not give a witness's evidence much weight. This rule does not

apply if the parties agree that a witness need not be presented for cross-examination. In some cases, the parties may wish to consider video-conferencing for witnesses from the United States whose cross-examination is expected to be short. Video-conferencing saves money and, today, is a realistic alternative to live testimony because the technology has advanced by leaps and bounds in recent years.

This system puts a premium on comprehensive, yet concise, well-organized witness statements. Again, the plaintiff or petitioner typically has the opportunity to present both opening statements and rebuttal statements following the opponent's statements. The parties can agree to a different order of presentation, however.

Effective witness statements require substantial input from the witnesses. Preferably each is written in the witness's own "voice." Lawyers also should prepare witnesses for cross-examination but need not prepare direct testimony as in an American civil jury trial. •

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