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FEDERAL DISTRICT COURT CREATES THREE PRONG POLLUTION EXCLUSION TEST

Recently, a Federal District Court Judge in the Northern District of Texas, in *Evanston Insurance Company v. Adkins*, 2006 WL 2848054 (Oct. 04, 2006), enunciated a three prong test to be used in the interpretation of the ISO CGL Pollution Exclusion. In *Adkins*, TXI owned and operated a cement plant. TXI hired Adkins, a welding and fabrication company, as an independent contractor for welding services at the cement plant. TXI sued Adkins in Texas state court for allegedly causing a fire at the cement plant. Evanston, Adkins' insurer, sought declaratory relief that its CGL policy issued to Adkins precluded coverage for TXI's claims.

As the basis of its coverage position and motion for summary judgment, Evanston asserted that the underlying lawsuit and TXI's claims for damages alleged merely economic damages not covered by the policy, or, alternatively, that four exclusions precluded coverage under the policy.

First, the Court addressed Evanston's argument that TXI's claims for "economic damages in the form of a gross business interruption loss" did not comprise "property damage." Essentially, Evanston argued that business interruption losses were not property damages, but rather economic losses not covered by the policy. The Court noted that the policy's definition of "property damage" included "loss of use of tangible property that is not physically injured." The Court observed that while TXI did indeed use the term "economic damages" in its pleadings, the Court stated that it must focus its analysis on the factual allegations that show the origin of the damages, rather than on the legal theories asserted. Finding that the underlying lawsuit alleged that Adkins' negligence caused the fire that resulted in physical damage to the plant where production of materials necessary for the manufacture of cement resulted in the loss of use of that property for 27 days constituted covered "property damage" for loss of use of that property.

Next, the Court addressed Evanston's reliance upon the Pollution Exclusion. Evanston argued that the welding slag which caused the fire was a pollutant which triggered the Pollution Exclusion. The Court first examined precedent which defines what constitutes a "pollutant." Noting that the terms "irritant" and "contaminant" are overly broad, the Court stated that, without some limiting principle, the Pollution Exclusion would extend far beyond its intended scope. The *Adkins* Court noted the Fifth and Seventh Circuits' "common sense" approach when interpreting the Pollution Exclusion. From the Fifth Circuit's opinion in *Certain Underwriters at Lloyd's London v. C.A. Turner Construction Company*, 112 F.3d 184 (1997), the *Adkins*' Court advocates a three prong test to analyze pollution claims.

- "First, the court should determine whether the substance at issue falls within the insurance policy's literal definition of pollutant. If it does not, then no pollutant exclusion would apply, and no analysis is necessary. If, however, the substance falls within the policy's literal definition of pollutant," then the analysis proceeds to the second prong;
- "then, the court must next determine whether it caused the damages in the underlying insurance claim." "The clause excludes coverage for expenses 'arising out of' or 'as a result of' the 'discharge, dispersal,

seepage, migration, release, escape or placement of pollutants.' . . . If the substance did not cause the damages in the underlying claim, then no pollution exclusion applies, despite the substance meeting the literal definition of pollutant. . . . If the substance at issue falls within the literal definition of pollutant, and it caused the damages in the underlying claim, the court should make a third inquiry: . . ."; and

- "[W]hether common sense and the 'reasonable, objective expectations of the insured' at the time of contracting make it reasonable to trigger the pollutant exclusion."

Notably, the Northern District takes the *C.A. Turner* Court's common sense analysis and boot straps the Massachusetts' "reasonable expectations" test from *Western Alliance Insurance Company v. Gill*, 686 N.E.2d 997 (Mass. 1997), a test not adopted by any other Texas court.

In reliance upon this "reasonable expectations" test, the Northern District determined that the Evanston Pollution Exclusion did not apply to the welding slag which purportedly started the fire and loss at issue. Although the Northern District did indeed find that welding slag was a pollutant and that the welding slag/pollutant did cause the fire and loss made the basis of the claim, the Court noted that the insured's reasonable expectation when purchasing the policy should be considered.

> [W]elding slag, which is present whenever one welds, or the molten metal particles produced during welding, qualifies as a "pollutant" under this policy, since such an interpretation would lead to clearly absurd results. Evanston issued a commercial general liability policy to Adkins, a welder. It would defy common sense and all reasonable expectations to interpret a welder's general liability insurance policy as negated by its pollutant exclusion any time welding slag causes damage or injury. Such an interpretation would reduce the contractual promise of coverage to a dead letter. Accordingly, this court finds that even though welding slag falls within the policy's literal definition of a pollutant, and even though the slag is the alleged cause of the damages in the underlying suit, the pollutant exclusion does not apply to bar coverage based on the presence of welding slag.

PROFESSIONAL SERVICES EXCLUSION RE-VISITED

In *Mid-Continent Casualty Company v. Davis-Ruiz Corporation*, 2006 WL 2850067 (Oct. 03, 2006), the Southern District of Texas had the opportunity to again review and construe the ISO Professional Services Exclusion. The Court noted that the Professional Services Exclusion failed to define "professional services" which are excluded under the Professional Services Exclusion. Thus, the Court examined established precedent which defined "professional services" as:

> A professional must perform more than an ordinary task to perform a professional service. To qualify as a professional service, the task must arise out of acts particular to the individual's specialized vocation. We do not deem an act a professional service merely because it is performed by a professional. Rather, it must be necessary for the professional to use his specialized knowledge or training.

The Court expressly found that the term "professional services" was not ambiguous. While the term is not specifically defined in the policy, the term is not ambiguous as it has been defined by the courts of Texas and is not reasonably subject to multiple interpretations.

In applying the definition of "professional services," the Court examined the relevant pleadings. It is noteworthy that the Court examined the pleadings under which the insured had been brought into the underlying lawsuit: the insured had been third-partied in under theories of contribution and indemnity. The Court did not examine or review the claimant/plaintiff's petition against the defendant as providing the factual basis and allegations to be construed against the policy under an eight corners' analysis. The Court examined and expressly addressed the factual claims and allegations made the basis of the defendant's third-party petition

against the insured. This analysis is noteworthy because of the practical implications and often used practice that many third-party claims for indemnity and contribution fail to include or assert any express or specific factual allegations – instead, common practice merely provides that a third-party plaintiff will simply assert that, in the off chance that the third-party plaintiff is found liable, that it is the fault and liability of the third-party defendant and that the third-party defendant is liable for contribution and/or indemnity to the third-party plaintiff. Thus, the common practice of factually-sparse and broad allegations in a third-party petition for contribution and/or indemnity may lack the factual predicate to implicate coverage under a third-party defendant's insurance policy.

Applying the "professional services" criteria to the factual allegations of the third-party petition, the Court found that the insured's inspection of the subject tank and ladder was the performance of a professional service. The third-party plaintiff alleged that it had contracted with the insured to perform the inspection and the insured "performed the inspection in accordance" with the Master Service Agreement. The MSA required that "the Work shall be performed in a good and workmanlike manner by qualified . . . workers," and the insured warranted that it was "experienced in the Work to be undertaken on behalf of" the third-party plaintiff and that the insured "possessed the skills and resources to complete the Work." Because the insured performed the work it was paid to do and as based upon the insured's experience and qualifications and specialized skills, the third-party plaintiff's factual allegations referring to the insured's tank and ladder inspections constituted the rendition of "professional services" which were excluded from coverage under the policy.