

**TWILIGHT REDUX: WILL THE POLLUTION EXCLUSION BE THE SILVER BULLET FOR  
COVERED CHINESE DRYWALL CLAIMS?**

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## I. Introduction

Following an increased need for drywall as a result of the housing boom and rebuilding efforts subsequent to numerous hurricanes spanning from 2003 to 2006, homeowners installed drywall manufactured in China for construction and refurbishing of homes. This drywall, commonly referred to as “Chinese drywall,” has given rise to a great deal of litigation. The U.S. Consumer Product Safety Commission’s (“CPSC”) most recent report, in August 2010, reported that they received over 3,500 incident reports related to drywall.<sup>2</sup> Homeowners that have Chinese drywall installed report health-related illnesses, corrosion-related property damage, and a “rotten egg” smell in their homes. While the exact processes causing these effects are unknown, preliminary studies reveal that Chinese drywall emits sulfurous gases. When combined with a rise in temperature and moisture, the gases cause corrosion and smell like “rotten eggs” because of a chemical reaction causing the emitted gases to become sulfuric acid.

The majority of claims reported are concentrated in five states,<sup>3</sup> 58 percent of which are from Florida.<sup>4</sup> As a result of these claims, a multitude of lawsuits have been filed. The U.S. Judicial Panel on Multidistrict Litigation consolidated a number of lawsuits brought over Chinese drywall in federal court in Louisiana.<sup>5</sup> It should come as no surprise that insurance coverage litigation has ensued. Those being held liable for Chinese drywall are turning to their insurers for defense and indemnity in the underlying lawsuits, many of whom are being denied coverage.

As the number of Chinese drywall claims increase, so will the number of insurance claims. It is reported that as of May 2010, forty coverage actions have been filed.<sup>6</sup> Although limited opinions have been issued to date with respect to coverage actions,<sup>7</sup> insurers will likely rely on the pollution exclusion to deny coverage.<sup>8</sup> That exclusion, however, is not the insurer’s silver bullet.

There is no nationwide uniform interpretation of the total or absolute pollution exclusion. States are split – some interpret the exclusion in favor of the policyholder and others interpret the exclusion broadly in favor of the insurer. Florida, with the highest concentration of Chinese drywall claims, falls into the latter category. This article provides an overview of the pollution exclusion, with an emphasis on Florida law, and discusses: (1) the drafting history and evolution of the pollution exclusion; (2) preliminary choice of law issues; (3) trigger of coverage; (4) whether Chinese drywall claims allege “property damage” caused by “occurrences;” (5) the

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<sup>2</sup> *Investigation of Imported Drywall Status Update*, U.S. Consumer Product Safety Commission (August 2010), available at <http://www.cpsc.gov/info/drywall/aug2010status.pdf>.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *In Re: Chinese Manufactured Drywall Prods. Liab. Litig.*, M.D.L. No. 2047 (E.D. La. June 15, 2009).

<sup>6</sup> David J. Woll, Mary Beth Forshaw & Joan E. Flaherty, *The Pollution Exclusion: Will It Wall Off Insurer Exposure to Drywall Claims?*, HB Litigation Conferences: Chinese Drywall Litigation and Coverage (May 18, 2010).

<sup>7</sup> *See, e.g., Finger v. Audubon Ins. Co.*, No. 09-8071, slip op. (Civ. Dist. Ct. Orleans Parish Mar. 22, 2010) (holding that pollution exclusion did not bar coverage for drywall claims).

<sup>8</sup> Christie Smythe, *Drywall Cases Could Hinge On Pollution Clause*, Law360, June 29, 2009, available at <http://www.law360.com/articles/101763> (“As the Chinese drywall cases arise, the pollution exclusion “is probably going to be the No. 1 exclusion that insurers raise up to try to deny coverage,” said Collin J. Hite, a partner with McGuireWoods LLP who represents policyholders....”).

application of the pollution exclusion to Chinese drywall claims; and (6) obtaining coverage for Chinese drywall claims.

## II. The Drafting History and Evolution of the Pollution Exclusion

Numerous courts and commentators have provided extensive review of the drafting history and evolution of the pollution exclusion.<sup>9</sup> This provides a basis for understanding the application of the total pollution exclusion found today in commercial general liability (CGL) policies. The total pollution exclusion grew out of the standard “accident” based CGL policy that existed prior to 1966.<sup>10</sup> As the name suggests, these policies provided coverage for bodily injury or property damage caused by an “accident.”<sup>11</sup> Although the term “accident” was undefined in these policies, courts typically interpreted the term “accident” “to encompass pollution-related injuries.”<sup>12</sup>

The ISO<sup>13</sup> responded to the broad availability of coverage for pollution-related injuries by changing the focus from an “accident”-based to an “occurrence”-based policy.<sup>14</sup> The 1966 CGL policy defined an “occurrence” as “an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury and property damage that was neither expected nor intended from the standpoint of the insured.”<sup>15</sup> These changes, however, did not achieve the industry’s objective, since standard CGL policies continued to be “generally understood ‘to cover pollution liability that arose from gradual losses.’”<sup>16</sup> Thus, changes to the policy language continued.

Four years later, in response to an “impending increase in claims for environmentally-related losses, and ... broadened coverage for pollution damage provided by the occurrence-based, CGL policy, the insurance industry drafting organizations began in 1970 the process of drafting and securing regulatory approval for the standard pollution-exclusion clause.”<sup>17</sup> The increase in claims was fueled by the Clean Air Act, which was an “effort to protect and enhance the quality of the nation’s air resources,” and by the recent environmental disasters such as

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<sup>9</sup> The Illinois Supreme Court, in *American States Insurance Co. v. Koloms*, 687 N.E.2d 72 (Ill. 1997), provided a comprehensive review of the history of this exclusion.

<sup>10</sup> *Koloms*, 687 N.E.2d 72.

<sup>11</sup> *Id.* at 79.

<sup>12</sup> *Id.*

<sup>13</sup> “Insurance Services Office, Inc. (ISO), an association of approximately 1,400 domestic property and casualty insurers ..., is the almost exclusive source of support services in this country for CGL insurance. ISO develops standard policy forms and files or lodges them with each State’s insurance regulators; most CGL insurance written in the United States is written on these forms.” *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 880 n.6 (Fla. 2007) (quoting *Hartford Fire Ins. Co. v. Cal.*, 509 U.S. 764, 772 (1993)).

<sup>14</sup> *Koloms*, 687 N.E.2d at 72.

<sup>15</sup> *Id.* at 79-80.

<sup>16</sup> *Morton Int’l, Inc. v. Gen. Accident Ins. Co. of Am.*, 629 A.2d 831, 849 (N.J. 1993) (quoting E. Joshua Rosenkranz, Note, *The Pollution Exclusion Through the Looking Glass*, 74 GEO. L.J. 1237, 1247 (1986)); see also *Koloms*, 687 N.E.2d at 80 (“[S]o long as the ultimate loss was neither expected nor intended, courts generally extended coverage to all pollution-related damage, even if it arose from the intentional discharge of pollutants.”) (quoting *New Castle Cnty. v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1196-97 (3d Cir. 1991)).

<sup>17</sup> *Morton*, 629 A.2d at 850 (citing Pub.L. No. 91-604, 84 Stat. 1676 (1970) (now codified at 42 U.S.C. §§ 7401 through 7642 (1983), as amended)).

Times Beach, Love Cannel and Torrey Canyon.<sup>18</sup> In 1970, the insurance industry's efforts resulted in the creation of the "qualified pollution exclusion."<sup>19</sup> This exclusion precluded coverage for bodily injury or property damage

arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.

The text of the exclusion became incorporated into the CGL form as exclusion "f." in 1973.<sup>20</sup>

This exclusion sparked debate and litigation, particularly with respect to the meaning of the words "sudden and accidental." Professor Jeffrey Stempel noted that this became "the most hotly litigated insurance coverage question[] of the late 1980s and early 1990s."<sup>21</sup> The nationwide litigation did not return uniform results. For example, some courts viewed the term "sudden" to be "unambiguous and must include a temporal element, as well as mean 'unexpected.'" Other courts, however, "found the phrase to be ambiguous, and construed it in favor of coverage, to mean simply 'unexpected' or 'unforeseen.'"<sup>22</sup> This debate ended when the insurance industry returned to the drafting table in an attempt to foreclose ambiguity that the qualified pollution exclusion created.

The product of the insurance industry's return to the drafting table first appeared in 1985, with the creation of the "absolute pollution exclusion." This exclusion had two significant features: "(i) the lack of any exception for the 'sudden and accidental' release of pollution, and (ii) the elimination of the requirement that the pollution be discharged 'into or upon land, the atmosphere or any watercourse or body of water.'"<sup>23</sup> Three years later, the insurance industry introduced a new version of the pollution exclusion, the "total pollution exclusion," differing in only one respect: "it remove[d] coverage for releases from products and for certain, off-site releases of pollutants."<sup>24</sup> This article focuses on the "absolute pollution exclusion."

The terms "absolute" or "total" are misleading; the evolution of the pollution exclusion reveals that despite the ISO's efforts to preclude policyholders from recovering from what the

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<sup>18</sup> *Koloms*, 687 N.E.2d at 80.

<sup>19</sup> *Id.*

<sup>20</sup> *See Id.* In 1973, the occurrence definition also changed to constitute "an accident, including continuous and repeated exposures to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured." *Id.* at n. 4.

<sup>21</sup> *Ctr. for Creative Studies v. Aetna Life & Cas. Co.*, 871 F. Supp. 941, 943 (E.D. Mich. 1994) (quoting J. Stempel, *Interpretation of Insurance Contracts: Law and Strategy for Insurers and Policyholders* 825 (1994)) (internal quotation marks omitted).

<sup>22</sup> Claudia G. Catalono, Annotation, *Construction of Qualified Pollution Exclusion Clause in Liability Insurance Policy*, 88 A.L.R. 5TH 493 (2001).

<sup>23</sup> *Id.* (citing *Weaver v. Royal Ins. Co. of Am.*, 674 A.2d 975 (1996)).

<sup>24</sup> John W. Ellison et al., *Recent Developments in the Law Regarding the "Absolute" and "Total" Pollution Exclusions, The "Sudden and Accidental" Pollution Exclusion and Treatment of the "Occurrence" Definition*, ALI-ABA Course of Study, May 8-9, 2008; *see Total Pollution Exclusion Endorsement CG 21 49 09 99* (1998) (text of exclusion attached to article).

industry considers “pollution-related injuries,” policyholders – like those affected by Chinese drywall – continue to properly find that the exclusion is not all-encompassing. This article examines the applicability of the total pollution exclusion to Chinese drywall claims.

### **III. Preliminary Choice of Law Issue**

As a preliminary matter and as illustrated by the drafting history of the exclusion, an early choice of law determination is important. While underlying Chinese drywall actions are currently held in the Multi-District Litigation Unit (MDL) in federal court in Louisiana, many insurance carriers oppose the incorporation of insurance coverage into the MDL. Insurer opposition to transfer to Louisiana is likely, due to the pro-policyholder position Louisiana courts have taken with respect to the pollution exclusion.<sup>25</sup> In fact, one Louisiana court has already held that the pollution exclusion does not apply in the case of a Chinese drywall claim.<sup>26</sup>

Florida applies the general principle of *lex loci contractus* (“law of the place where the contract is made”) in making a choice of law determination for matters arising out of contract. This principle provides that, in the absence of a contractual forum selection provision, a contract is governed by the law of the state in which the contract is made.<sup>27</sup> The Eleventh Circuit Court of Appeals has held that “[a] contract is made at the place where the last act necessary to complete the contract is done.”<sup>28</sup> In the case of insurance policies, the last act necessary to complete the contract is typically the delivery of the policy, although this is not an exclusive test.<sup>29</sup>

### **IV. Trigger of Coverage**

#### **a. Competing Trigger of Coverage Theories**

Before addressing whether the total pollution exclusion applies, a few threshold issues must be considered, one of which is the trigger of coverage. Since there are potentially fifteen pollution exclusion variants, and policies may be delivered to the same policyholder in different states, trigger is critical. In each potentially implicated standard CGL policy, coverage is triggered by an “occurrence,” which is defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” The trigger issue seems straightforward because, in most circumstances, the event causing damage occurs simultaneously with the resulting harm. An occurrence determination becomes particularly difficult, however,

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<sup>25</sup> See, e.g., *Finger*, No. 09-8071; During the course of writing this article, Judge Steven D. Merryday of the Middle District of Florida, on September 22, 2010, ordered that an insurance coverage action relating to an underlying Chinese drywall claim be moved to Eastern District Court of Louisiana as part of the MDL. See *Chartis Specialty Ins. Co. v. Pate*, No. 8:10-cv-1465-T-23EAJ (M.D. Fla. Sept. 22, 2010).

<sup>26</sup> *Finger*, No. 09-8071.

<sup>27</sup> *State Farm Mut. Auto. Ins. Co. v. Roach*, 945 So. 2d 1160, 1163 (Fla. 2006).

<sup>28</sup> *Shapiro v. Assoc. Int’l Ins. Co.*, 899 F.2d 1116, 1119 (11th Cir. 1990).

<sup>29</sup> *Sturiano v. Brooks*, 523 So. 2d 1126 (Fla. 1988). The *Sturiano* court viewed the *lex loci contractus* rule as a favorable choice of law analysis on the grounds that “we live in a migratory, transitory society” and “[t]o allow one party to modify the contract simply by moving to another state would substantially restrict the power to enter into valid, binding, and stable contracts.” *Id.* at 1129-1130.

when – as in the case of Chinese drywall – the event causing harm is not discovered, or is not discovered to have been harmful, until some later point in time.

The issue has been a particularly nettlesome one for the courts. Courts in different jurisdictions – even courts in the same jurisdiction – have reached disparate conclusions under comparable facts and identical policy language. In continuing-damage or delayed-manifestation cases, courts have adopted no less than five theories of coverage.<sup>30</sup> First is the continuous trigger approach, which holds that all policies on the risk from the initial exposure through manifestation and remediation are triggered.<sup>31</sup> Second is the exposure theory, which presumes that damage occurs when exposure to the causative agent or event takes place and not when the symptoms of the exposure become manifest.<sup>32</sup> Third is the injury-in-fact theory, which focuses on when an injury actually occurred. The injury need not be manifest, but must exist in fact at some point in time.<sup>33</sup> Fourth is the manifestation theory, which holds that policies are triggered when damage becomes manifest or diagnosable.<sup>34</sup> To make matters muddier, there is a double-trigger theory, which holds that there are two triggers – exposure and manifestation – and nothing in between.<sup>35</sup> The very existence of five different trigger theories reflects poorly on the clarity of the drafting of CGL policies. As one Florida court stated:

The insurance company contends that the language is not ambiguous, but we cannot agree and offer as proof of that pudding the fact that the Supreme Court of California and the Fifth Circuit in New Orleans have arrived at opposite conclusions from a study of essentially the same language.<sup>36</sup>

Of the five possibilities, the continuous trigger is the obvious preference for policyholders affected by Chinese drywall, as it presents the broadest view of what constitutes an occurrence and implicates the greatest number of policies. While Florida case law and rules of contract construction support the proposition that the continuous trigger approach applies in this context, there is a movement toward applying the less favorable manifestation theory.

#### **b. Plain Meaning Analysis Supports Continuous Trigger**

Courts often make trigger of coverage decisions based on rules of contract interpretation; indeed, most trigger questions are resolved as a matter of law on summary judgment. Thus, a quick synopsis of Florida law on insurance policy interpretation is appropriate:

If the terms of an insurance policy are susceptible to two interpretations, the interpretation that sustains the claim for indemnity or that allows the greater indemnity will be

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<sup>30</sup> See *Dow Chem. Co. v. Assoc. Indem. Corp.*, 724 F. Supp. 474, 478-79 (E.D. Mich. 1989).

<sup>31</sup> See, e.g., *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034 (D.D.C. 1981).

<sup>32</sup> See, e.g., *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980).

<sup>33</sup> *Am. Home Prods. Corp. v. Liberty Mut. Ins. Co.*, 565 F. Supp. 1485 (S.D.N.Y. 1983), *aff'd as modified*, 748 F.2d 760 (2d Cir. 1984).

<sup>34</sup> *Eagle-Picher Indus., Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 12 (1st Cir. 1982).

<sup>35</sup> *Zurich Ins. Co. v. Raymark Indus., Inc.*, 514 N.E. 2d 150 (Ill. 1987).

<sup>36</sup> *Sec. Ins. Co. of Hartford v. Investors Diversified Ltd., Inc.*, 407 So. 2d 314, 316 (Fla. 4th DCA 1981).

adopted.<sup>37</sup> An insurance policy must be “liberally construed” in favor of the insured so as not to defeat “without a plain necessity” the right of indemnity.<sup>38</sup> An insurer cannot use obscure phrases or exceptions to defeat the purpose for which the policy was procured.<sup>39</sup> Any insurance policy must receive a “reasonable and practical interpretation, consistent with the intent of the parties.”<sup>40</sup> Florida courts liberally construe CGL policies in favor of policyholders so as to promote the reasonable expectation of the policyholder that insurance will be available.<sup>41</sup> The terms used in an insurance policy are to be construed in light of the skill and experience of ordinary people.<sup>42</sup>

Under those principles, a continuous trigger of coverage should be applied. The CGL policy provisions prescribe the right to indemnity when triggered by an “occurrence,” which is generally defined in policies to include *continuous* or repeated exposure to conditions, which causes property damage during the policy period. The focus is on *damage* as the signal event. The damage can occur and become patent almost immediately, or, as in the case of Chinese drywall, the damage can occur but not become manifest until a later date. Thus, the continuous trigger approach should apply to a Chinese drywall claim, submitted under a CGL policy.

### c. Florida Case Law on Trigger of Coverage

The most oft-cited case on trigger of coverage is *Keene v. Insurance Co. of North America*,<sup>43</sup> the first decision to adopt the continuous trigger approach. *Keene* had a substantial impact on Florida law, as discussed below.

In *Keene*, the court held that there were multiple triggers of coverage, from the point of first exposure to manifestation. *Keene* involved asbestosis claims brought against an asbestos manufacturer. The insurers argued that coverage existed only when damage manifested itself during the policy period. The court disagreed:

The language of each policy at issue in this case clearly provides that an ‘injury,’ and not the ‘occurrence’ that causes the injury, must fall within a policy period for it to be covered by the policy. Most suits brought under this type of policy involve an injury and an occurrence that transpired simultaneously, or, at least, in close temporal proximity to one another. In cases involving asbestos-related disease, however, inhalation – the ‘occurrence’ that causes the injury – takes place substantially before the manifestation of the ultimate injury – asbestosis,

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<sup>37</sup> *Effort Enters. of Fla., Inc. v. Lexington Ins. Co.*, 666 So. 2d 930, 931-32 (Fla. 4th DCA 1995); *N.Y. Life Ins. Co. v. Kincaid*, 186 So. 675, 677 (Fla. 1939).

<sup>38</sup> *Feldman v. Centr. Nat’l Ins. Co. of Omaha*, 279 So. 2d 897, 898 (Fla. 3d DCA 1973); *see also Westmoreland v. Lumbermans Mut. Cas. Co.*, 704 So. 2d 176, 179 (Fla. 4th DCA 1997) (“Florida law is ... well-settled that insuring or coverage clauses are construed in the broadest possible manner to effect the greatest extent of coverage.”).

<sup>39</sup> *Rosen v. Godson*, 422 F.2d 1082 (5th Cir. 1970) (applying Florida law).

<sup>40</sup> *Fla. Resid. Prop. & Cas. Joint Under. Ass’n v. Kron*, 721 So. 2d 825, 826 (Fla. 3d DCA 1998).

<sup>41</sup> *Pepper’s Steel & Alloys, Inc. v. U. S. Fid. & Guar. Co.*, 668 F. Supp. 1541, 1545 (S.D. Fla. 1987).

<sup>42</sup> *State Farm Mut. Auto. Ins. Co. v. Fischer*, 16 So. 3d 1028, 1031 (Fla. 2d DCA 2009) (quoting *Gen. Star Indem. Co. v. West Fla. Village Inn, Inc.*, 874 So. 2d 26, 29 (Fla. 2d DCA 2004); *Brill v. Indianapolis Life Ins. Co.*, 606 F. Supp. 265, 268 (M.D. Fla. 1985).

<sup>43</sup> 667 F.2d at 1034.

mesothelioma, or lung cancer. Furthermore, although it is not known how little exposure is required to cause disease, inhalation may occur over a long period of time. As a result, inhalation may continue through numerous policy periods, the disease may develop during subsequent policy periods, and manifestation may occur in yet another policy period. For an insured such as Keene, different insurers are likely to be on the risk at different points in the development of each plaintiff's disease.... We conclude that each insurer on the risk between the initial exposure and the manifestation of disease is liable to Keene for indemnification and defense costs.<sup>44</sup>

As for allocation of damages between carriers on the risk, the *Keene* court determined:

In sum, the allocation of rights and obligations established by the insurance policies would be undermined if either the exposure to asbestos or the manifestation of asbestos-related disease were the sole trigger of coverage. We conclude, therefore, that inhalation exposure, exposure in residence, and manifestation all trigger coverage under the policies. We interpret 'bodily injury' to mean any part of the single injurious process that asbestos-related diseases entail.<sup>45</sup>

In *Trizec Properties, Inc. v. Biltmore Construction Co.*,<sup>46</sup> the Eleventh Circuit recognized that continuous damage can trigger multiple policy periods. The court specifically rejected manifestation as a trigger and noted that other Florida courts had rejected exposure as the sole trigger of coverage. *Trizec* involved an insurer's obligations to defend its policyholder against a claim alleging property damage owing to the policyholder's negligent construction of a roof deck on a shopping mall. The construction took place from 1971 to 1975, the insurer was on the risk from 1972 to 1976, and the damage manifested in 1979. The issue before the court was whether the insurer had a duty to defend. The insurer argued that it did not, because the damage did not become manifest until after the policy had expired. The Eleventh Circuit rejected that argument:

The potential for coverage is triggered when an 'occurrence' results in 'property damage.' There is no requirement that the damages 'manifest' themselves during the policy period. Rather, it is the damage itself which must occur during the policy period for coverage to be effective. Here, the actual date that the damage occurred is not expressly alleged, but the language of the complaint, at least marginally and by reasonable implication, could be construed to allege that the damage (cracking and leaking of roof deck with resultant rusting) may have begun to occur immediately after installation, 1971 to 1975, and continued gradually thereafter over a period of time.... Because the complaint alleges facts which fairly bring the cause within the coverage of the insurance contract, there is a potential for coverage and [the insurer] owes [the policyholder] a duty to defend the main action.<sup>47</sup>

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<sup>44</sup> *Id.* at 1040-41.

<sup>45</sup> *Id.* at 1047.

<sup>46</sup> 767 F.2d 810, 812 (11th Cir. 1985) (applying Florida law).

<sup>47</sup> *Id.* (internal citation omitted).

In *Carey-Canada, Inc. v. Aetna Casualty & Surety Co.*,<sup>48</sup> and *Carey-Canada Inc. v. California Union Insurance Co.* (“Carey II”),<sup>49</sup> the court was called upon to determine whether insurers had duties to defend and indemnify claims of property damage brought against their policyholder, an asbestos manufacturer. The court surmised that Florida would not deviate from the rules established in *Keene*. The Middle District also expressly endorsed *Keene* in *CSX Transportation, Inc. v. Admiral Insurance Co.*<sup>50</sup>

After *CSX*, however, the Middle District’s decisions on trigger took an odd turn, beginning with *Harris Specialty Chemicals, Inc. v. United States Fire Insurance Co.*<sup>51</sup> In *Harris*, an unreported decision, the court seemingly misread *Trizec* to hold that manifestation is the trigger of coverage under Florida law. Two years later, in *Auto Owners Insurance Co. v. Travelers Casualty & Surety Co.*,<sup>52</sup> the Middle District quoted *Trizec* for the principle that “[t]here is no requirement that the damages be ‘manifest’ during the policy period. Rather it is the damage itself which must occur during the policy period for coverage to be effective,”<sup>53</sup> but then went on to conclude that “this court finds that the ‘trigger’ for coverage for the CGL policies is when the damage occurs and if damage is continuously occurring, the ‘trigger’ is the time the damage ‘manifests’ itself or is discovered.”<sup>54</sup>

Subsequent Florida decisions continued to apply the manifestation theory as the general rule.<sup>55</sup> As with all rules though, there are exceptions. In *North River Insurance Company v. Broward County Sherriff’s Office*,<sup>56</sup> for example, an insurer sued its policyholder, the Sherriff’s Office, to determine the insurer’s coverage obligations with respect to a lawsuit for false imprisonment and malicious prosecution. Although the court applied the manifestation theory and rejected *Trizec* as applied to the particular facts, the court went on to explain that:

[*Trizec*] is analogous to the asbestosis line of cases, in which courts have distinguished the facts in those cases from cases similar to that *sub judice* by noting that the injuries caused by exposure do not manifest themselves until a substantial time after the exposure causing the injury. ... Furthermore, the phrase ‘continuous or repeated exposure’ ... has doubtful application in a situation as the

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<sup>48</sup> Nos. CIV. A. 84-3113 JHP, 85-1640 JHP, 1988 WL 169287 (D.D.C. Mar. 31, 1988) (applying Florida law).

<sup>49</sup> 748 F. Supp. 8 (D.D.C. 1990) (applying Florida law).

<sup>50</sup> No. 93-132-CIV-J-10, 1996 WL 33569825 (M.D. Fla. Nov. 6, 1996).

<sup>51</sup> No. 3:98-CV-351-J-20B, 2000 WL 34533982 (M.D. Fla. July 7, 2000).

<sup>52</sup> 227 F. Supp. 2d 1248 (M.D. Fla. Sept. 17, 2002).

<sup>53</sup> *Id.* at 1265-66.

<sup>54</sup> *Id.* at 1266.

<sup>55</sup> See *North River Ins. Co. v. Broward Cnty. Sheriff’s Office*, 428 F. Supp. 2d 1284, 1289 (S.D. Fla. 2006) (“Florida courts follow the general rule that the time of occurrence ... is the time at which the plaintiff’s injury manifests....”); *Essex Builders Group, Inc. v. Amerisure Ins. Co.*, 485 F. Supp. 2d 1302 (M.D. Fla. 2006 (“[T]he time of occurrence within the meaning of an ‘occurrence’ policy is the time at which the injury first manifests itself.”); *Assurance Co. of Am. v. Lucas Waterproofing Co., Inc.*, 581 F. Supp. 2d 1201, 1206 (S.D. Fla. 2008) (“Florida courts follow the general rule that potential coverage under an insurance policy is triggered when property damage manifests itself, not when the negligent act or omission giving rise to the damage occurs.”) *Mid-Continent Cas. Co. v. Frank Casserino Constr., Inc.*, Case No. 6:09-cv-1065-Orl-31GJK, 2010 WL 2431900, at \*5 (M.D. Fla. June 16, 2010) (“[C]overage under a CGL policy is triggered when property damage manifests itself, not when the damage occurs.”).

<sup>56</sup> 428 F. Supp. 2d 1284.

present case, and would place considerable strain on the words ‘exposure’ and ‘conditions.’ ... ‘Exposure’ and ‘generally harmful conditions’ conjure images of lead based paint and asbestos fibers, not false imprisonment and malicious prosecution.<sup>57</sup>

*Broward County* demonstrates the state’s recognition that the manifestation theory is not always appropriate in circumstances where the injuries do not become evident until sometime after the exposure, which is the situation in Chinese drywall cases. Thus, in the case of Chinese drywall claims, cases like *Keene* and *Broward County* should be relied on to demonstrate that the manifestation theory should be substituted with the more appropriate contiguous trigger or injury-in-fact approaches.

## V. Chinese Drywall Claims Allege “Property Damage” Caused by “Occurrences”

The issue of whether Chinese drywall claims allege “property damage” caused by an “occurrence” also must be considered before determining whether any exclusions apply. Standard CGL language provides:

We will pay those sums that the insured becomes legally obligated to pay as damages because of . . . ‘property damage’ to which this insurance applies. We will have the right and duty to defend the insured against any ‘suit’ seeking those damages.

A subsequent section states that the insurance applies to property damage only if the property damage is “caused by an ‘occurrence.’” An occurrence is defined to mean “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” “Property damage” means:

- a. Physical injury to tangible property, including all resulting loss of use of that property. . . ; or
- b. Loss of use of tangible property that is not physically injured.

These provisions can be synthesized as follows: coverage exists if there is an occurrence which causes property damage and/or loss of use. The following sections of this article demonstrate that Chinese drywall claims allege “property damage” caused by an “occurrence.”

### a. “Occurrence”

CGL policies require that the “property damage” be caused by an “occurrence.” While the policy defines “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions,” it does not define the term “accident.” The Florida Supreme Court, in *State Farm Fire & Casualty Co. v. CTC Development Corp.*,<sup>58</sup> held

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<sup>57</sup> *Id.* at 1292 (citations omitted).

<sup>58</sup> 720 So. 2d 1072, 1076 (Fla. 1998).

that the term “accident . . . encompasses not only ‘accidental events,’ but also injuries or damage neither expected nor intended from the standpoint of the insured.”<sup>59</sup> Adopting *CTC*, the Florida Supreme Court later construed the term “occurrence” to mean an unintended event, including faulty or negligent construction.<sup>60</sup>

Florida’s well-established interpretation of the term “occurrence” supports a finding that Chinese drywall claims allege “occurrences.”<sup>61</sup> At least one court, applying the same interpretation of “occurrence” as Florida, has already held that the allegations in an underlying Chinese drywall claim are sufficient to constitute an “occurrence.”<sup>62</sup> Assuming the insured requesting coverage under a CGL policy did not have knowledge that the drywall was defective and substantially certain to cause damage, courts are likely to find that these claims constitute “occurrences.”

### **b. “Property Damage”**

To establish coverage, there must be “property damage,” as defined by the policy and Florida law. Florida courts construe the term “property damage” broadly.<sup>63</sup> The seminal Florida decision interpreting “property damage” is *United States Fire Insurance Co. v. J.S.U.B., Inc.*<sup>64</sup> J.S.U.B. built several homes. After completion, damage to the foundations, drywall and other interior portions of the homes appeared, due to a subcontractor’s use of poor soil and improper soil compaction and testing. J.S.U.B. was covered under a standard CGL policy. The insurer asserted there was no coverage for the costs of repairing structural damage, including damage to the foundation and drywall. J.S.U.B. made the necessary repairs and filed suit. The circuit court ruled in favor of the carrier, citing to the Florida Supreme Court’s 1980 decision in *LaMarche v. Shelby Mutual Insurance Co.* J.S.U.B. appealed, and the Second District Court of Appeal reversed, holding that *LaMarche* did not control.

The Florida Supreme Court affirmed, holding that “faulty workmanship or defective work that has damaged the otherwise non-defective completed project has caused physical injury to tangible property within the plain meaning of the definition in the policy.”<sup>65</sup> The court also stated: “If there is no damage beyond the faulty workmanship or defective work, then there may be no resulting property damage.”<sup>66</sup> Thus, the key distinction *J.S.U.B.* makes is that “property damage” consists of the defective work itself and “resulting property damage,” meaning damage to something other than the defective work or the defective component of the work. The

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<sup>59</sup> *Id.*

<sup>60</sup> *See U.S. Fire Ins. Co. v. J.S.U.B.*, 979 So. 2d 871, 888 (Fla. 2007) (“faulty workmanship that is neither intended nor expected from the standpoint of the [the insured] can constitute an ‘accident’ and, thus, an ‘occurrence’”); *Rolyn Cos., Inc. v. R & J Sales of Tex., Inc.*, 671 F. Supp. 2d 1314 (S.D. Fla. 2009) (same).

<sup>61</sup> *See CTC Dev. Corp.*, 720 So. 2d at 1072; *J.S.U.B.*, 979 So. 2d 871; *Rolyn Cos.*, 671 F. Supp. 2d 1314.

<sup>62</sup> *Builders Mut. Ins. Co. v. Dragas Mgmt. Corp.*, No. 2:09cv1985, 2010 WL 2813397 (E.D. Va. July 15, 2010).

<sup>63</sup> *See McCreary v. Fla. Resid. Prop. & Cas. Joint Under. Ass’n*, 758 So. 2d 692, 694 (Fla. 4th DCA 1999) (finding loss of enjoyment of homeowner’s property constitutes property damage).

<sup>64</sup> 979 So. 2d at 871.

<sup>65</sup> *Id.* at 889.

<sup>66</sup> *Id.*

*J.S.U.B.* court concluded that “physical injury to the completed project that occurs as a result of the defective work can constitute ‘property damage’ as defined in CGL policy.”<sup>67</sup>

Some might suggest that this distinction was qualified by the Florida Supreme Court in the companion decision of *Auto-Owners Insurance Co. v. Pozzi Window Co.*<sup>68</sup> The facts in that case were different, requiring the Florida Supreme Court to more closely consider the difference between property damage and resulting property damage. A homeowner purchased windows from Pozzi, which were installed by a subcontractor. Water leaks resulted in a suit against the window manufacturer, the retailer, the builder, and the subcontractor. The insurer refused to provide coverage for the cost of repair or replacement of the windows. The issue was ultimately certified to the Florida Supreme Court. As the opinion in *Pozzi* had the benefit of the *J.S.U.B.* decision, its discussion of the meaning of *J.S.U.B.* is important.

The *Pozzi* court found that *J.S.U.B.* held as follows: “faulty workmanship or defective work that has damaged the completed project has caused physical injury to tangible property is within the plain meaning of the definition in the policy.”<sup>69</sup> If, however, “there is no damage beyond the faulty workmanship or defective work, then there may be no resulting property damage.”<sup>70</sup> Importantly, the *Pozzi* court observed that *J.S.U.B.* “rejected the insurer’s argument that faulty workmanship that injures only the work product itself does not result in property damage and that there could never be property damage in cases of faulty construction because the defective work rendered the entire project damaged from its inception.”<sup>71</sup>

The *Pozzi* court then turned to the distinction between a defective product incorporated into a larger whole, and a non-defective product that is negligently installed. The court found that if the windows purchased by the homeowner were not defective before being installed, there would be coverage for the cost of repair or replacement of windows because the windows themselves became damaged by the defective installation. If, however, the windows were defective before being installed, there would be no coverage for the reinstallation of defective windows regardless of proper or improper installation.

In *Mid-Continent Casualty Co. v. Clean Seas Co., Inc.*,<sup>72</sup> the court sought to apply *Pozzi* to a dispute over defective paint. The insured was sued in several actions arising from the sale and application of defective boat bottom paint. The court found that the allegations that the failure of the paint product resulted in increased marine growth that damaged the hulls of boats, that removal of the paint caused damage to the boat hulls, and that boats were rendered unusable because the paint could not be removed, were claims of “property damage.”<sup>73</sup> The court reasoned that “property damage” was alleged because the defective paint resulted in physical injury to other tangible property, being the boats themselves.

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<sup>67</sup> *Id.* at 891.

<sup>68</sup> 984 So. 2d 1241 (Fla. 2008).

<sup>69</sup> *Id.* at 1246.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 1247 (internal quotation marks omitted).

<sup>72</sup> No. 3:06-CV-518-J-32MCR, 2009 WL 812072 (M.D. Fla. Mar. 27, 2009).

<sup>73</sup> *Id.* at \*4.

In contrast to *Clean Seas*, another recent decision, *St. Paul Fire & Marine Insurance Co. v. Sea Quest International, Inc.*,<sup>74</sup> found that claims brought against a yacht maker for costs of repairing defective workmanship did not constitute “property damage.” The court emphasized that there is “a difference between the claims for the costs of repairing or removing defective work alone, which is not a claim for property damage, and a claim for the costs of repairing damage caused by the defective work, which is a claim for property damage.”<sup>75</sup> Accordingly, the court found that Sea Quest’s claims for faulty and incomplete construction of the yacht did not constitute “property damage,” as they were not claims for “damage beyond the faulty workmanship or defective work.”<sup>76</sup>

Last, we address a decision that is currently being appealed to the Eleventh Circuit Court of Appeals, *Amerisure Mutual Insurance Co. v. Auchter Co.*<sup>77</sup> Auchter contracted with Amelia Island Co. (Amelia) to construct various buildings. As part of the contract, Amelia paid Auchter for concrete roof tiles that were delivered to the project site before they were used. After the completion of the project, the roof tiles began falling from the roof, a problem exacerbated by later storms. Arbitration ensued, with a resulting award in favor of Amelia for over \$2 million for defective installation of the roof. Amerisure had issued a series of CGL policies to Auchter, as well as umbrella coverage. The carrier defended Auchter in the arbitration proceedings under a reservation of rights, subsequently filing a declaratory action claiming that Amelia’s suit against Auchter was not for “property damage.”

The court in *Auchter* seriously misapplied *J.S.U.B.* and *Pozzi*. The court phrased the issue as whether the “cost for the removal and replacement of the entire roof including the non-defective roof tiles is property damage when the faulty installation has caused physical damage to some of the individual roof tiles, and can only be remedied by replacing the entire roof[.]” The answer should have been yes. Despite the court’s finding that “a roof tile is tangible property and there is no dispute that many of the tiles sustained ‘physical injury[.]’” the *Auchter* court held that the lack of an allegation that the faulty installation caused damage to some other component of the project was fatal.<sup>78</sup> The court’s finding ignored not only the CGL policy language but also the holdings in *J.S.U.B.* and *Pozzi*. The CGL policy language does not require that “property damage” be to “other property.”<sup>79</sup> Moreover, the Florida Supreme Court has not made a distinction between property damage to the completed product or to “other property” when considering what constitutes “property damage.”<sup>80</sup>

Despite *Auchter*, it is clear that Chinese drywall claim allegations constitute “property damage,” since the defective product – the Chinese drywall – causes damage beyond the actual

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<sup>74</sup> 676 F. Supp. 2d 1306 (M.D. Fla. 2009).

<sup>75</sup> *Id.* at 1314-15 (quoting *J.S.U.B.*, 979 So. 2d at 889).

<sup>76</sup> *Id.* at 1318.

<sup>77</sup> No. 3:08-CV-645-J-32HTS, 2010 WL 457386 (M.D. Fla. Feb. 4, 2010).

<sup>78</sup> *Id.* at \*6.

<sup>79</sup> The CGL policies define “property damage” as “[p]hysical injury to tangible property, including all resulting loss of use of that property.”

<sup>80</sup> See *Pozzi*, 984 So. 2d at 1247 (quoting *J.S.U.B.*, 979 So. 2d at 889) (“[W]e rejected the insurer’s argument that faulty workmanship that injures only the work product itself does not result in ‘property damage’ and that there could never be property damage in cases of faulty construction because the defective work rendered the entire project damaged from its inception.”).

installation of the product. Those affected by Chinese drywall commonly allege that the gases released from the drywall are corrosive to metal components in households,<sup>81</sup> resulting in “premature failure of electrical and mechanical devices.”<sup>82</sup> As a result, homeowners submit claims for replacement of items such as electric wires, copper pipes, HVAC units, and electrical devices and appliances. Thus, the damage resulting from Chinese drywall clearly extends far beyond the actual installation of the material, illustrating that the claims allege “property damage” as defined in CGL policies and under Florida law.

## **VI. Application of the Pollution Exclusion to Chinese Drywall Claims**

After addressing the threshold issues of trigger of coverage, property damage, and occurrence, we can now consider whether the total pollution exclusion precludes coverage for Chinese drywall claims. Although Florida courts have yet to address this issue, the pollution exclusion is no stranger to judicial interpretation. In fact, “[p]ollution exclusions are a frequently litigated topic, and there exists not just a split of authority, but an absolute fragmentation of authority.”<sup>83</sup> Courts have split into one of two camps:

The first camp consists of courts that have concluded that the clause is intended to preclude coverage for environmental pollution, not for all contact with substances that can be classified as pollutants. The second camp consists of courts that have refused to read such a distinction into seemingly unambiguous pollutant exclusions.<sup>84</sup>

Courts generally engage in a two-prong analysis to determine the applicability of this exclusion: (1) whether the injury causing substance is a “pollutant” as contemplated by the policy; and (2) whether there has been a “discharge, dispersal, seepage, migration, release or escape” of a pollutant within the meaning of the policy.

Principles applied by Florida courts with respect to exclusionary clauses are important here:

When an insurer relies on an exclusion to deny coverage, it has the burden of demonstrating that the allegations in the complaint are cast solely and entirely within the policy exclusions and are subject to no other reasonable interpretation. Further, exclusionary clauses are generally disfavored, so courts construe any ambiguity in exclusionary language strictly against the insurer.<sup>85</sup>

Therefore, the insurer bears the burden to demonstrate that the substance emitted from the Chinese drywall constitutes a “pollutant,” and that there has been a “discharge, dispersal, seepage, migration, release or escape” of the substance causing injury from the drywall.

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<sup>81</sup> *In Re: Chinese Manufactured Drywall Prods. Liab. Litig.*, M.D.L. No. 2047, D.E. 2380 at ¶ 5.

<sup>82</sup> *Id.* at ¶ 6.

<sup>83</sup> *Travco Ins. Co. v. Ward*, No. 2:10cv14, 2010 WL 2222255, at \*16 (E.D. Va. June 13, 2010) (internal quotation marks omitted).

<sup>84</sup> *Id.* (citations omitted) (internal quotation marks omitted).

<sup>85</sup> *IDC Constr., LLC v. Admiral Ins. Co.*, 339 F. Supp. 2d 1342, 1348 (S.D. Fla. 2004) (citing *Northland Cas. Co. v. HBE Corp.*, 160 F. Supp. 2d 1348, 1359 (M.D. Fla. 2001)).

This section demonstrates that insurers will not be able to meet this heavy burden because: (1) the substances in Chinese drywall do not constitute “pollutants;” (2) no “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” has occurred of an injury producing substance; and (3) the language of the pollution exclusion is ambiguous as applied in the context of Chinese drywall claims.

**a. The substances off-gassed from the Chinese drywall do not constitute “Pollutants” as that term is defined in pollution exclusions and under Florida law**

Florida case law supports the proposition that the substances off-gassed from Chinese drywall do not constitute “Pollutants.” The term “Pollutants” is defined as “any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.” A great deal of litigation over this term has ensued. The leading case interpreting the pollution exclusion to date in Florida is *Deni Associates v. Florida, Inc. v. State Farm Fire & Casualty Co.*<sup>86</sup> *Deni* and its progeny demonstrate that the pollution exclusion is inapplicable in the context of Chinese drywall claims.

*Deni* involved two unrelated actions where the insurance company denied coverage on the basis of the pollution exclusion. The pollution exclusions in both cases were substantially similar. The first action concerned an accidental ammonia spill from a machine in a commercial building. Individuals asserted claims against Deni Associates of Florida, Inc., the insured, for personal injuries resulting from the inhalation of ammonia as well as for loss of income from covenants. Deni submitted a claim under its CGL policy.

The second action involved a business, Land-O-Sun Groves, which contracted with a company to spray insecticides on a citrus grove by helicopter. While spraying, the helicopter accidentally sprayed two men standing on adjacent property. The two men sued for injuries resulting from the insecticides. Like Deni, Land-O-Sun Groves submitted a claim under its CGL policy.

In addressing whether the pollution exclusion precluded coverage, the Florida Supreme Court considered the divergence in opinion among courts as to the clarity of the exclusion. The court sided with what it incorrectly believed to be the majority opinion – the second camp of thought – when it stated: “the pollution exclusion is clear and unambiguous so as to preclude coverage for all pollution related liability.”<sup>87</sup> Rather than examine the exclusion’s drafting history, the court considered the plain meaning of the term “irritant” and defined it as “a substance that produces a *particular* effect, not one that generally or probably causes such effects.”<sup>88</sup> After considering the harmful effects that ammonia and pesticide can pose on human health, the court found that both substances constituted “pollutants” and concluded that both incidents were excluded under the pollution exclusion.<sup>89</sup>

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<sup>86</sup> 711 So. 2d 1135 (Fla. 1998).

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* The court also “decline[d] to adopt the doctrine of reasonable expectations” which upholds “the insured’s expectations as to the scope of coverage ... provided that such expectations are objectively reasonable.” *Id.* at 1140.

<sup>89</sup> *Id.* at 1141.

The Eleventh Circuit adopted *Deni's* holding in *Technical Coating Applicators, Inc. v. United States Fidelity & Guaranty Co.*<sup>90</sup> In *Technical Coating*, the court found that the absolute pollution exclusion precluded coverage for bodily injury claims brought by individuals against an insured contractor. The individuals alleged that the contractor negligently applied polyurethane foam during the course of repairs, which resulted in injuries from the inhalation of vapors emitted from the foam. Relying on *Deni*, the court explained that whether the pollution exclusion applies turns on whether the substance at issue produces an irritating effect:

Using examples such as paint and glue, the court observed that, although these products normally do not inflict injury, the products' ability to produce an *irritating effect* places the products within the policies' definition of an 'irritant.' Consequently, a product that causes no harm when used properly still may be classified as a pollutant under the exclusion: It can obviously cause harm when it is not used properly. Thus, the pollution exclusion ... precludes coverage....<sup>91</sup>

The following year, the Eleventh Circuit affirmed a lower court's decision that the pollution exclusion precluded coverage for bodily injury caused by the inhalation and ingestion of lead.<sup>92</sup> The court concluded that "lead" was a "pollutant" because lead was specifically recognized as a pollutant under state laws governing the discharge of pollutants and federal laws addressing the harmful effects of lead on individuals. The court noted that lead was a chemical and thus was expressly identified as the type of pollutant covered by the exclusion. The court's analysis effectively adopted *Deni's* interpretation of the term "irritant," since it focused on the substance's effect, which led to the court's finding that lead fell within the plain meaning of the term "pollutant."<sup>93</sup>

In *James River Insurance Co. v. Ground Down Engineering, Inc.*,<sup>94</sup> the insured sought coverage for a claim brought against it by a client for its alleged negligence in failing to discover pollutants and construction debris while conducting a property-site assessment. The client sought damages for environmental remediation. The Eleventh Circuit looked to the facts in the underlying complaint "[t]o determine whether the claims brought ... [in the underlying suit] arose out of pollution such that they are covered by the pollution exclusion."<sup>95</sup> In rejecting the insured's argument that the construction debris was not an "irritant or contaminant," the court explained that the debris constituted "environmental contamination": "[T]he pollution exclusion is not actually limited to irritants or contaminants. The definition for pollutants states that 'irritants or contaminants' covers 'waste' which includes 'all ... materials to be disposed of, recycled, stored, reconditions, or reclaimed.'"<sup>96</sup>

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<sup>90</sup>157 F.3d 843, 845 (11th Cir. 1998).

<sup>91</sup> *Id.* (citations omitted) (emphasis added).

<sup>92</sup> *Auto Owners Ins. Co. v. City of Tampa Hous. Auth.*, 231 F.3d 1298 (11th Cir. 2000).

<sup>93</sup> *See also Nova Cas. Co. v. Waserstein*, 424 F. Supp. 2d 1325 (S.D. Fla. 2006) (concluding that the term "pollutant," within the meaning of the policy, included claims alleging that the insured exposed individuals to "living organisms," "microbial populations," "microbial contaminants," and "indoor allergens").

<sup>94</sup> 540 F.3d 1270 (11th Cir. 2008).

<sup>95</sup> *Id.* at 1275.

<sup>96</sup> *Id.*; *see also Philadelphia Indem. Ins. Co. v. Yachtsman's Inn Condo. Assoc., Inc.*, 595 F. Supp. 2d 1319 (S.D. Fla. 2009) (concluding that bodily injury caused by the exposure to battery acid and raw sewage and waste fell within the scope of the pollution exclusion).

Despite the plethora of cases interpreting the pollution exclusion, very few courts have interpreted it in the context of a Chinese drywall claim.<sup>97</sup> Although Florida consumers do not have the benefit of a case considering whether the substances at issue in a Chinese drywall claim constitute pollutants under the exclusion, there is well-established case law to guide a Florida court's analysis. As demonstrated below, despite *Deni* and its progeny's plain meaning particular effect analysis, insurers will be unable to establish that the fumes emitted from Chinese drywall constitute a "pollutant."<sup>98</sup>

Insurers are likely to assert that the sulfide gas emitted from the drywall constitutes a pollutant as defined in the total pollution exclusion. What this argument fails to consider, however, is that *Deni* and its progeny require that for a substance to be classified as a pollutant, a court must consider the substance's *effect*. Pollution exclusions typically define "pollutants" as an "irritant or contaminant." Implicit in the plain-meaning of those terms is the notion that a substance cannot irritate or contaminate an inanimate object—a wooden desk, for example. Neither *Deni* nor its progeny have held that a substance's effect make it a pollutant where the substance caused an effect on a nonliving organism. Significantly, the cases applying *Deni*'s plain-meaning analysis discussed in this section have found that a particular substance constitutes a pollutant where the substance has an effect on people's health. These findings are in line with the plain-meanings of the terms "irritant" and "contaminant."

While the facts and circumstances will vary from case to case, all Chinese drywall claim allegations contain the same underlying theory: sulfide gas emitted from the drywall combines with moisture which creates sulfuric acid. It is the combination of the substance emitted – sulfide gas – with an element external to the defective product – humidity – that creates sulfuric acid, which causes corrosion on metal. These circumstances are not analogous to those previously discussed in *Deni* and its progeny.

Moreover, since the particular *effect* caused by the offending substance here – the sulfur compounds – is *corrosion*, not irritation or contamination, it cannot be said that the substances emitted from the Chinese drywall constitute pollutants. Corrosion is defined as: "The act or process of corroding," which leads to the definition of "corrode," which is "[t]o impair steadily; deteriorate."<sup>99</sup> "Deteriorate" means: "To diminish or impair in quality, character, or value.... To grow worse; denigrate....To weaken or disintegrate; decay."<sup>100</sup> This definition does not mirror *Deni*'s interpretation of "irritant."<sup>101</sup>

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<sup>97</sup> See e.g., *Travco*, 2010 WL 2222255 (applying Virginia law, pollution exclusion in homeowners policy barred coverage for damage to insured's residence caused by toxic gases released by Chinese drywall because sulfur gases released by drywall constituted pollutants); *Finger v. Audubon Ins. Co.*, No. 09-8071, slip op. (Civ. Dist. Ct. Orleans Parish Mar. 22, 2010).

<sup>98</sup> See *IDC Constr.*, 339 F. Supp. 2d at 1348 (finding that it is the insurer's burden to demonstrate that the allegations in the underlying complaint fall solely within the exclusion).

<sup>99</sup> *Reliance Ins. Co. v. Cooper/T. Smith Corp.*, No. 00-0251-BH-C, 00-0280-BH-C, 2001 WL 530438, at \*2 (S.D. Ala. Apr. 24, 2001) (citing American Heritage Dictionary of the English Language (4th ed. 2000)) (applying plain meaning of words to undefined terms when interpreting the word "corrosion" within the "corrosion exclusion"); see also *St. Paul Fire & Marine Ins. Co. v. Lago Canyon, Inc.*, No. 06-60889-CIV, 2009 WL 4855484, at \*7, n.12 (S.D. Fla. Dec. 9, 2009) (applying plain meaning of undefined term "corrosion" within corrosion exclusion).

<sup>100</sup> *Id.*

<sup>101</sup> *Deni*, 711 So. 2d at 1139 ("An irritant is a substance that produces a *particular* effect, not one that generally or probably causes such effects.").

Further, policyholders can argue that if the insurer intended to classify pollutants to include substances that “corrode” as well as “irritate,” as the drafter of the policy, it should have either included the corrosion exclusion<sup>102</sup> or included the term “corrosive” within its definition of “pollutant,” rather than engage in post-claim underwriting. The Florida Supreme Court has approved of this reasoning:

If U.S. Fire [the insurer] intended to preclude coverage based on the cause of action asserted, it was incumbent on U.S. Fire to include clear language to accomplish this result. *See Container Corp. of Am. v. Maryland Cas. Co.*, 707 So. 2d 733, 736 (Fla.1998) (‘Had Maryland wished to limit Container’s coverage to vicarious liability, it could have done so by clear policy language.’). In fact, there is a breach of contract endorsement exclusion, not present in the CGL policies at issue in this case, that excludes coverage for breach of contract claims.<sup>103</sup>

The term “pollutant” is also inapplicable in the context of Chinese drywall claims because defective products are not included within the definition of “pollutant.” No decision applying Florida law has applied the pollution exclusion in the context of a defective product. A defective product is not the type of substance envisioned when considering the terms “irritant or contaminant.” As discussed in section II of this article, the insurance industry continued to revise the pollution exclusion in response to an increasing number of federal and state laws that addressed traditional environmental pollution.<sup>104</sup> Moreover, substantial evidence exists to support the argument that the insurance industry did not intend for the exclusion to apply to non-traditional pollution.<sup>105</sup> Based on these findings, it would be unreasonable for a court to conclude that the term “pollutant” includes substances emitted from defective products. Exclusions for named “pollutants” already exist for other defective products, such as asbestos and lead. One court, considering whether the pollution exclusion applied, explained:

If a literal interpretation were applied to the ... pollution exclusion, there would be no need for this additional asbestos exclusion, for the pollution exclusion excludes coverage for ‘bodily injury’ arising from ‘contamination’ by ‘vapors ... and all other irritants or contaminants.’ Asbestos clearly falls into this definition if it is literally interpreted.<sup>106</sup>

To expand the definition of a term already defined would render an absurd result, which would be contrary to the holding in *Deni* that exclusions cannot be interpreted in a manner that would produce absurd results.<sup>107</sup>

A U.S. Consumer Product Safety Commission (CPSC) November 23, 2009, Release supports a finding that the substance emitted from Chinese drywall does not constitute an irritant.

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<sup>102</sup> Lee E. Russ & Thomas E. Segalla, *Couch on Insurance*, §153:80 (3d ed. 2009)

<sup>103</sup> *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 884 (Fla. 2007) (internal citations omitted).

<sup>104</sup> *See supra* Part II.

<sup>105</sup> *Id.*

<sup>106</sup> *Nat’l Union Fire Ins. Co. v. Am. Re-Ins.*, 351 F. Supp. 2d 201, (S.D. N.Y. 2005) (citing *Sphere Drake Ins. Co. v. Y.L. Realty Co.*, 990 F. Supp. 240, 244 (S.D. N.Y. 1990) (internal citations omitted).

<sup>107</sup> *Deni*, 711 So. 2d at 1140 (“Suffice it to say that insurance policies will not be construed to reach an absurd result.”).

The Release reported that the levels of compounds found within Chinese drywall homes are below irritant levels. The USPC reported the findings from an indoor air study concerning Chinese drywall:

Both hydrogen sulfide [hydrosulfuric acid] and formaldehyde are known irritants at certain levels, although the concentrations found for each of these compounds in this fifty-one home study *were below the irritant levels*. Nevertheless, it is possible that additive or synergistic effects of these and other compounds in the subject homes could cause irritant effects.<sup>108</sup>

Evidence like this is beneficial to policyholders in proving that the emissions from the drywall do not constitute pollutants as defined in the policy.

Although the pollution exclusion has been deemed unambiguous by *Deni* and its progeny, other Florida courts have found that the phrase “pollutant and contaminants” without an accompanying description or definition is ambiguous. For example, in *Florida Farm Bureau Insurance Co. v. Birge*,<sup>109</sup> the court held that policy exclusion for damage resulting from “pollutants and contaminants” was ambiguous. Thus, policyholders should be able to successfully assert that interpretation of the term “contaminant” should not include sulfide gas.

Policyholders need to contend with the fact that sulfur is classified by governmental agencies as a pollutant.<sup>110</sup> Relying on unrelated statutes classifying the elements as such, however, is inappropriate, since Chinese drywall claims do allege a violation of such statutes. At least one jurisdiction has applied this reasoning when interpreting the pollution exclusion.<sup>111</sup> Relying on technical statutes is also contrary to *Deni*'s mandate that the terms be interpreted based on their plain meaning. If the language of the pollution exclusion is unambiguous, as insurers contend, then there is no need to rely on such statutes to determine whether a particular substance is in fact a pollutant.<sup>112</sup>

Another way to show that the injury producing substance in Chinese drywall claims does not constitute a “pollutant” is for policyholders to focus on the “odor” emitted from the drywall, rather than the sulfide gas. Homeowners typically allege the presence of a “rotten egg” odor. Odors have been held to constitute physical damage.<sup>113</sup> Moreover, courts have held that the total

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<sup>108</sup> Executive Summary of Release, U.S. Consumer Product Safety Commission (Nov. 23, 2009), *available at* <http://www.cpsc.gov/info/drywall/nov2009execsum.pdf>.

<sup>109</sup> 659 So. 2d 310 (Fla. 2d DCA 1994).

<sup>110</sup> *See, e.g.*, 42 U.S.C. § 11001 (2004) (classifying hydrogen sulfide gas a hazardous substance pursuant to the Community Right to Know Act; 40 C.F.R. § 261.33(f) (2004).

<sup>111</sup> *Firemen's Ins. Co. of Wash., D.C. v. Kline & Son Cement Repair, Inc.*, 474 F. Supp. 2d 779 (E.D. Va. 2007) (refusing to consider an unrelated statute where the underlying lawsuit charged no violation of the statute).

<sup>112</sup> *See Shalimar Contractors, Inc. v. Am. State Ins. Co.*, 975 F. Supp. 1450 (M.D. Ala. 1997) (relied on by *City of Tampa Hous. Auth.*, 121 F. Supp. 2d 1365).

<sup>113</sup> *See Essex Ins. Co. v. Bloomsouth Flooring Corp.*, 562 F.3d 399, 406 (1st Cir. 2009) (“[O]dor can constitute physical injury to property under Massachusetts law, and also that allegations that an unwanted odor permeated the building and resulted in a loss of use of the building are reasonably susceptible to an interpretation that physical injury to property has been claimed.”).

pollution exclusion does not apply to noxious odors.<sup>114</sup> In fact, the pollution exclusion does not include the term “odor” in the list of types of pollutants.<sup>115</sup> Recently, however, the Southern District of Florida found that the pollution exclusion applies where the underlying complaint alleged, among other things, sewage odor.<sup>116</sup> Nonetheless, the odor argument cannot be overlooked, because even if some of the allegations – namely those related to the fumes or vapors related to the corrosion – are implausibly held to be excluded, if the court agrees that allegations relating to odors are not, then the insurer has a duty to defend the entire suit.<sup>117</sup>

**b. No “discharge, dispersal, seepage, migration, release or escape” occurred to trigger the pollution exclusion**

Even if an insurer is able to establish that the substance emitted from the Chinese drywall constitutes a pollutant, the insurer must also satisfy the second prong of the total pollution exclusion analysis, which requires the insurer to show that there was a “discharge, dispersal, seepage, migration, release or escape” of the pollutant. These terms are not specifically defined in the policy.

An Eleventh Circuit decision considered the meaning of these terms. In *Bituminous Casualty Corp. v. Advanced Adhesive Technology, Inc.*,<sup>118</sup> the court considered whether the pollution exclusion applied to bar coverage for a death allegedly caused by fumes from the insured’s adhesive product. The court held that the language of the second prong was ambiguous. The court found the term “discharge” had many definitions, including “the act of discharging: removal of a load: unloading ... a firing off: expulsion of a charge: explosion ... a flowing or issuing out ... *emission*, vent ... something that is *emitted* or evacuated...”<sup>119</sup> The court concluded that the pollution exclusion did not apply because the term “discharge” did not precisely and unambiguously describe the process that produced the vapors emitted from the insured’s adhesive product.<sup>120</sup>

Two years later, the Eleventh Circuit refused to adhere to *Bituminous*,<sup>121</sup> concluding that the absolute pollution exclusion was unambiguous and that it applied where the underlying

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<sup>114</sup> See *Smith v. Reliance Ins. Co.*, 807 So. 2d 1010 (La. App. Ct. 5th Cir. 2002); *Barney Greengrass, Inc. v. Lumbermans Mut. Cas. Co.*, No. 09 Civ. 7697(NRB), 2010 WL 3069560, at \*9 (S.D. N.Y. July 27, 2010) (“Strictly construing the pollution exclusion clause in light of ‘common speech’ and the ‘reasonable expectations of a businessperson,’ we find that the pollution exclusion unambiguously does *not* apply to Barney Greengrass’ restaurant ‘odors.’”) (emphasis in original).

<sup>115</sup> The total pollution exclusion lists the following types of forms of substances as pollutants: smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.

<sup>116</sup> *Essex Ins. Co. v. Dixon*, No. 09-61755-Civ, 2010 WL 3746295, at \*5 (S.D. Fla. Sept. 21, 2010).

<sup>117</sup> *Northland Ca. Co. v. HBE Corp.*, 160 F. Supp. 2d 1348, 1360 (M.D. Fla. 2001) (quoting *Tropical Park, Inc. v. U.S. Fid. & Guar. Co.*, 357 So. 2d 253, 256 (Fla. 3d DCA 1978) (“If the complaint alleges facts partially within and partially outside the scope of coverage, the insurer is obligated to defend the entire suit.”) (internal quotation marks omitted)).

<sup>118</sup> 73 F.3d 335 (11th Cir. 1996) (applying Georgia law).

<sup>119</sup> *Id.* (quoting Webster’s Third New Int’l Dict. 644 (1976) (emphasis added in original)).

<sup>120</sup> *Id.* It is worth noting that the court did not limit its analysis to only the term “discharge.” *Id.* at 338. Rather, it considered the other terms found within the second prong of the pollution exclusion analysis and found that they did not apply. *Id.* The court considered the dictionary definitions of these terms as well. *Id.*

<sup>121</sup> See *Technical Coating*, 157 F.3d 843 (applying Florida law).

claims alleged that a contractor “negligently applied [roofing] foam and elastometric coatings and exposed ... employees and students to vapors emitted by these products.”<sup>122</sup> The court rejected the applicability of *Bituminous* and relied on *Deni*. As a result, the court’s analysis lacked any discussion regarding the second prong of the pollution exclusion analysis. The court assumed, without any discussion, that the emissions of vapors from the foam constituted discharges, and then concentrated its analysis on whether the substance constituted a pollutant. In short, *Technical* never decided whether an emission constituted a discharge, as the court did in *Bituminous*. As such, *Technical* only considered the first prong of the pollution exclusion analysis, failing to give effect to every term in the provision: a violation of the rules of policy construction.<sup>123</sup>

The following year, the Middle District, in *Auto Owners Insurance Co. v. City of Tampa Housing Authority*,<sup>124</sup> relied on an Alabama case, *Shalimar Contractors, Inc. v. American States Insurance Co.*,<sup>125</sup> to support its finding that the pollution exclusion was unambiguous. *Shalimar* instructed that the court should not resort “to highly technical and specific definitions found in places other than the insurance policy” to interpret the terms “discharge, dispersal, release and escape.”<sup>126</sup> The *City of Tampa* court did not address which specific process of transmitting the pollutant applied.

The Eleventh Circuit engaged in another incomplete analysis four years later in *Admiral Insurance Co. v. Feit Management Co.*<sup>127</sup> The court there held that the pollution exclusion applied, without engaging in any discussion as to which term – “discharge, dispersal, seepage, migrations, release or escape” – applied. As evidence, the court held that “the pollutants in this case were discharged, dispersed, released *or* escaped from the hot water heater....”<sup>128</sup> The use of the word “or” demonstrates the court’s unwillingness to commit itself to the particular process by which the fumes were released. This analysis also violated the rules of policy construction.

These cases demonstrate that courts applying Florida law have provided limited guidance with respect to the second prong of the pollution exclusion analysis. To engage in a proper analysis, in line with rules of policy construction and interpretation, it is necessary to determine which specific term describes the process by which the alleged injury producing substance is transmitted. Given the dearth of Florida law on this issue, other jurisdictions’ application of the second prong should be consulted.

One method courts employ to interpret the terms found in the second prong is to define the terms “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” in the context of environmental law.<sup>129</sup> For example, in *Essex Insurance Co., Inc. v. Berkshire Environmental*

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<sup>122</sup> *Id.* at 844.

<sup>123</sup> *Id.*; see *Price v. S. Home Ins.*, 100 Fla. 338 (Fla. 1930) (finding that the terms of a policy provisions should not be treated as mere surplusage, but effect should be given to all the terms of a policy).

<sup>124</sup> 121 F. Supp. 2d at 1365.

<sup>125</sup> 975 F. Supp. at 1450.

<sup>126</sup> *City of Tampa Hous.*, 231 F.3d at 1368.

<sup>127</sup> 321 F.3d 1326 (11th Cir. 2003).

<sup>128</sup> *Id.* (emphasis added).

<sup>129</sup> See *Motorists Mut. Ins. Co. v. RSJ, Inc.*, 926 S.W.2d 679 (Ken. Ct. App. 1996) (finding that drafters of policy utilized environmental terms of art with respect to “discharge,” “dispersal,” “seepage,” “migration,” “release,” or

*Consultants*,<sup>130</sup> the court defined those terms by relying on environmental law terms found in federal environmental statutes:

‘Discharge’ is defined in the federal regulations interpreting the Resource, Conservation and Recovery Act ... as the ‘accidental or intentional spilling, leaking, pumping, pouring, emitting, emptying, or dumping of hazardous waste into or any land or water’ .... ‘Release’ is defined in § 101(22) of the Comprehensive Environmental Response, Compensation and Liability Act of 1990 ... as any spilling, leaking, pumping, emitting, emptying, discharging ... into the environment.<sup>131</sup>

The court found these terms inapplicable in *Berkshire*, holding that they “generally are used with reference to damage or injury caused by improper disposal or containment of hazardous waste.”<sup>132</sup> Therefore, the court refused to apply the pollution exclusion in that case.

Policyholders can refute any insurer resistance to application of environmental terms to define the terms “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” in Florida by citing to Florida courts’ reference to statutes to define terms found within the first prong of the analysis.<sup>133</sup>

The California Supreme Court, in *MacKinnon*,<sup>134</sup> also engaged in a detailed analysis of the second prong of the pollution exclusion. While the court refused to classify the terms in the second prong as “environmental law terms of art,” the court did consider the exclusionary language within the context of the policy, rather than the mere “dictionary meaning” of those terms. The court did not consider the terms in isolation, but rather considered how they were “used *in conjunction* with ‘pollutant,’”<sup>135</sup> and concluded that: “[L]imiting the scope of the pollution exclusion to injuries arising from events commonly thought of as pollution, i.e. environmental pollution, also appears to be consistent with the choice of terms ‘discharge, dispersal, release, or escape.’”<sup>136</sup> Thus, the court in that case also refused to apply the pollution exclusion.

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“escape”); *W. Am. Ins. Co. v. Tufco*, 409 S.E.2d 692, 699 (N.C. Ct. App. 1991), *rev’d on other grounds*, *Gaston County Dyeing Mach. Co. v. Northfield Ins. Co.*, 524 S.E.2d 558, 564-65 (N.C. 2000) (“While they are not defined in the policy, the terms “discharge” and “release” are terms of art in environmental law and include “escape” by definition and “dispersal” by concept.”); *Essex Ins. Co., Inc. v. Berkshire Env’tl. Consultants, Inc.*, No. CIV A. 99-30280-FHF, 2002 WL 226172, at \*3 (D. Mass. Feb. 7, 2002).

<sup>130</sup> 2002 WL 226172 at \*3.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *See, e.g., Deni Assocs. v. Fla., Inc. v. State Farm Fire & Cas. Co.*, 711 So. 2d 1135, 1141 (Fla. 1998) (“The Federal Clean Air Act categorizes ammonia as an extremely hazardous substance....”); *City of Tampa Hous.*, 231 F.3d at 1300 (“[L]ead is specifically recognized as a pollutant under Florida laws governing pollutant discharge, prevention and removal.”).

<sup>134</sup> *MacKinnon v. Truck Ins. Exch.*, 73 P.3d 1205 (Cal. 2003).

<sup>135</sup> *Id.* at 1216.

<sup>136</sup> *Id.*

The Pennsylvania Supreme Court's decision in *Lititz*,<sup>137</sup> provides another example of a court's second prong analysis. The court there considered whether the exclusion's requirement that the alleged injury arise from a "discharge, dispersal, release or escape" of pollutants was ambiguous when evaluating the physical process by which lead-pigmented paint becomes available for human ingestion or inhalation. Specifically, the court assessed the "specific form of movement in question" and considered the language used to describe the movement of lead-pigmented paint instructive. Finding that the process of lead-pigmented paint surface degradation did not occur quickly, the court concluded that the "exclusionary language [did] not clearly include or exclude the physical process ... at issue, but [wa]s, as to that process, ambiguous."<sup>138</sup> Thus, the court held that the pollution exclusion did not preclude coverage for the injuries alleged to have occurred in that case.

The cases that applied the second prong of the pollution exclusion analysis provide a framework for policyholders to advocate for the inapplicability of the exclusion. If a policyholder is able to show that the insurer has not met its burden to demonstrate that the process by which the sulfur from Chinese drywall is emitted falls within one of the enumerated processes found within the exclusion, then the exclusion cannot be applied. There are three reasons this burden is difficult to meet.

First, the process by which the injury producing substance is emitted from the Chinese drywall has not been definitively established. As evidence, the CPSC's most recent November 2010 report concerning drywall stated: "This update describes new developments in the *ongoing* investigation of imported drywall.... We continue to investigate long term corrosion on electrical and fire safety components...."<sup>139</sup> Therefore, it would be premature for an insurer to claim that the injury producing substance is occurring as a result of either "discharge," "dispersal," "seepage," "migration," "release," or "escape" from the Chinese drywall.

Second, insurers, in determining their duty to defend, are limited to the "allegations in the complaint filed against the insured."<sup>140</sup> Allegations in the complaint are not sufficient to determine the exact means by which the damage from Chinese drywall is occurring. For example, the amended complaint in *In re: Chinese-Manufactured Drywall Product Liability Litigation* filed on July 8, 2009, states:

20. Defendants' drywall was made with waste material from scrubbers on coal-fired power plants, also called "fly ash." These materials can leak into the air and emit one of several sulfur compounds including sulfur dioxide and hydrogen sulfide.

21. When combined with moisture in the air, these sulfur compounds create sulfuric acid. Sulfuric acid has been known to dissolve solder joints, corrode coils

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<sup>137</sup> *Lititz Mut. Ins. Co. v. Steely*, 567 A.2d 975 (Pa. 2001).

<sup>138</sup> *Id.* at 982.

<sup>139</sup> *Investigation of Imported Drywall Status Update*.

<sup>140</sup> *Tropical Park*, 357 So. 2d at 256 ("The law is also well-settled that the duty of an insurance carrier to defend a claim falling within its insurance contract depends solely on the allegations in the complaint filed against the insured. The original complaint under this rule must allege facts which fairly bring the cause within the coverage of the insurance contract even though ultimately there is no liability.").

and copper tubing - creating leaks, blackening coils and causing HVAC systems and refrigerators to fail. Sulfuric acid has also been shown to corrode copper electrical wiring and plumbing components. Not only does it blacken and corrode coils, it can harm metals such as chrome, brass and silver.<sup>141</sup>

The exact means, either through “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” cannot be ascertained. The plaintiff in the above-quoted complaint only refers to “leaks” from the materials. This does not describe the actual process by which the injury producing substance actually causes property damage. As such, it would be contrary to the rules of insurance policy interpretation for an insurer to allege that the second prong of the pollution exclusion has been satisfied.

Last, the process suggests that the substance emitted from the Chinese drywall is not the injury producing substance, but it is when that substance reacts with its external environment that an injury producing substance – sulfuric acid – is created.<sup>142</sup> If this is the case, the damage cannot be said to be resulting directly from the “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” of a substance from the drywall, but rather caused by a substance that is formed following the “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” of the Chinese drywall produced substance. This further supports the argument that there has been no “discharge,” “dispersal,” “seepage,” “migration,” “release,” or “escape” of a pollutant from the Chinese drywall.

**c. The pollution exclusion is ambiguous as applied to the underlying allegations of Chinese Drywall claims.**

Even if courts disagree with all of the above arguments, a court must find, at the very least, that the total pollution exclusion is ambiguous as applied in the context of Chinese drywall claims. The Florida Supreme Court’s holding in *Auto-Owners Insurance Co. v. Anderson*,<sup>143</sup> supports this proposition:

If the relevant policy language is susceptible to more than one reasonable interpretation, one providing coverage and another limiting coverage, the insurance policy is considered ambiguous. Ambiguous policy provisions are interpreted liberally in favor of the insured and strictly against the drafter who prepared the policy. Likewise, ambiguous insurance policy exclusions are construed against the drafter and in favor of the insured. In fact, exclusionary clauses are construed even more strictly against the insurer than coverage clauses.<sup>144</sup>

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<sup>141</sup> MDL No. 2047, 2009 WL 2390764, at ¶¶ 19-20 (S.D. Lo. July 8, 2009).

<sup>142</sup> Returning to the first prong of the analysis, this argument serves as a counter-argument to an insurer’s contention that other jurisdictions have classified hydrogen sulfide as a pollutant under the pollution exclusion since hydrogen sulfide is not the substance being emitted from the drywall.

<sup>143</sup> 756 So. 2d 29 (Fla. 2000).

<sup>144</sup> *Id.* at 34.

Further, an insured's interpretation of the provision does not need to be correct; an insured only needs to show that the interpretation is reasonable.<sup>145</sup>

Insurers will undoubtedly turn to *Deni* and its progeny to argue that the pollution exclusion has already been found to be unambiguous. That argument, however, fails to acknowledge that *Deni* found the exclusion to be unambiguous with respect to a particular factual context. It is reasonable to interpret the total pollution exclusion, in the context of Chinese drywall claims, to be inapplicable where damage results from a product's failure. Drafting history provides substantial supporting evidence, since the insurance industry has previously represented to insurance regulators that the exclusion is not meant to apply in the Chinese drywall context. Specifically, the insurance industry has stated that the pollution exclusion does not apply to claims based on products and completed operations. For example, industry representatives assured state regulators, when the regulators were asked to approve the pollution exclusion, that the exclusion would not be applied so broadly so as to exclude coverage for a policyholder's products and completed operations.<sup>146</sup> Moreover, the Insurance Services Office, Inc., has published a number of statements regarding the pollution exclusion clarifying that the exclusion does not apply to damage arising out of the products and completed operations of builders and other insureds.<sup>147</sup> Based on these representations, it should be difficult for a court to find that the total pollution exclusion excludes coverage for property damage occurring following the installation of defective Chinese drywall. Therefore, a court is likely to find that the exclusionary language is ambiguous and construe the provision in favor of the insured.

## **VII. Obtaining Coverage for Chinese Drywall Claims**

### **a. Getting Drafting History & Interpretative Materials Admitted**

The admission of drafting history and interpretative materials is important. Courts that have reviewed the drafting history of the exclusion acknowledge the purpose of the exclusion and apply it accordingly. For example, as the Illinois Supreme Court stated: "We would be remiss, ... if we were to simply look to the bare words of the exclusion, ignore its *raison d' être*, and apply it to situations which do not remotely resemble traditional environmental contamination."<sup>148</sup> Insurers will likely rely on Florida case law that has held the pollution exclusion to be unambiguous, resulting in rejection of policyholders' attempts to include drafting history and interpretative materials as part of the exclusion's interpretation.<sup>149</sup>

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<sup>145</sup> *Cont'l Ins. Co. v. Roberts*, 410 F.3d 1331, 1334 (11th Cir. 2005) (The policyholders "do not need to show that their interpretation of the term 'household' in this insurance contract is the correct one. All they need to show is that the term is ambiguous, and the existence of two competing, reasonable interpretations establishes ambiguity.").

<sup>146</sup> *See Nav-Its v. Selective Ins. Co.*, 869 A.2d 929, 936 (N.J. 2005) (statements to New Jersey State Insurance Department); *Richardson v. Nationwide Ins. Co.*, 826 A.2d 310, 334 (D.C. 2003) (statements to Texas State Board of Insurance).

<sup>147</sup> *See Kimber Petroleum Corp. v. Travelers Indem. Co.*, 689 A.2d 747, 752-54 (N.J. App. 1997).

<sup>148</sup> *Am. States Ins. Co. v. Koloms*, 687 N.E.2d 72, 81 (Ill. 1997).

<sup>149</sup> *Deni*, 711 So. 2d at 1139 ("[U]nless we conclude that the policy language is ambiguous, it would be inappropriate for us to consider the arguments pertaining to the drafting history of the pollution exclusion clause.") (citing *Dimmitt Chevrolet, Inc. v. Se. Fid. Ins. Corp.*, 636 So. 2d 700 (Fla. 1993)).

Since *Deni*, Florida courts have considered drafting history even without a finding of ambiguity. In a 2007 Florida Supreme Court decision, for example, the Court considered drafting history and interpretative materials.<sup>150</sup> The court concluded that consideration of the history behind CGL policies was necessary because, just as is the case with the pollution exclusion, the insuring language and exclusions in CGL policies had been modified over the years.

Recently, the Middle District of Florida considered interpretative materials in reaching its decision, while also expressly stating that the policy was not ambiguous.<sup>151</sup> In that case, a cardiologist brought an action against his insurer for denial of coverage under the cardiologist's long-term professional disability insurance plan. One of the issues considered was whether a factual dispute existed on the issue of the interpretation of the phrase "your occupation." While noting that the term was unambiguous, the court still considered the insurer's claims manual interpreting "own occupation" to determine the applicability of the term.

Courts' willingness to consider extrinsic evidence, even in light of unambiguous policy language, is supported by well-established general rules of contract law. The Southern District of Florida, in *F.W.F., Inc. v. Detroit Diesel Corp.*,<sup>152</sup> citing to the Restatement Second of Contracts, stated: "There is generally no requirement that an agreement be ambiguous before evidence of trade usage or course of dealing can be used to establish, supplement or qualify terms or conditions of a contract."<sup>153</sup>

Courts applying Florida law have specifically addressed the admissibility of evidence of trade usage and course of dealing within the insurance industry. The Florida Supreme Court considered provisions found in other insurance policies as evidence of "an *established custom* in the insurance industry as to the language used by insurers in drafting clauses...."<sup>154</sup> The court acknowledged the benefit of evidence of usage of trade:

[C]onfronted with a term that is standardized in the industry, we must recognize the principle that usage of trade which is so well settled and generally known that all persons engaged in such trade may be considered as contracting with reference to it, has been regarded as forming a part of a contract of insurance entered into to protect risks in such trade.<sup>155</sup>

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<sup>150</sup> *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871, 877-80 (Fla. 2007).

<sup>151</sup> *Natarajan, M.D. v. Paul Revere Life Ins. Co.*, No. 8:04-cv-26112-T-17TGW, 2010 WL 2509886 (M.D. Fla. June 18, 2010).

<sup>152</sup> 494 F. Supp. 2d 1342 (S.D. Fla. 2007). Although the court applied admiralty jurisdiction in *F.W.F.*, the court explained, citing to an Eleventh Circuit decision, that "general federal maritime law has adopted the general rules of contract interpretation and construction." *Id.* at 1356 (citing *United States ex. Rel. E. Gulf, Inc. v. Metzger Towing, Inc.*, 910 F.2d 775, 779 (11th Cir. 1990)).

<sup>153</sup> *Id.* at 1367. (citing RESTATEMENT (SECOND) OF CONTRACTS § 222, cmt. b. (1981)); *See also* 12 Richard A. Lord, Williston on Contracts § 34:5 (4th ed. 2010).

<sup>154</sup> *Auto-Owners Ins. Co. v. Anderson*, 756 So. 2d 29, 36 (Fla. 2000) (citing *Nat'l Merch. Co., Inc. v. United Serv. Auto. Ass'n*, 400 So. 2d 526, 530 (Fla. 1st DCA 1981)).

<sup>155</sup> *Nat'l Merch. Co.*, 400 So. 2d at 531 (quoting 13 Appleman, *Insurance Law and Practice*, § 7388 at 189 (1976)) (internal quotation marks omitted).

While these decisions did not hold the terms at issue to be unambiguous,<sup>156</sup> other jurisdictions have considered such evidence, even when it has been determined that the policy provision was unambiguous.

At least one court has adopted this position in the context of the application of the pollution exclusion.<sup>157</sup> The Pennsylvania Supreme Court considered evidence of an insurance industry memorandum issued to the Department of Insurance when seeking approval of the “sudden and accidental” exception to the pollution exclusion, even where the terms of the policy were unambiguous:

In the law of contracts, custom in the industry or usage in the trade is always relevant and admissible in construing commercial contracts and does not depend on any obvious ambiguity in the words of the contract. If words have a special meaning or usage in a particular industry, then members of that industry are presumed to use the words in that special way, whatever the words mean in common usage and regardless of whether there appears to be any ambiguity in the words.<sup>158</sup>

The court went on to explain that:

[T]he parol evidence rule does not apply in its ordinary strictness where the existence of a custom or usage to explain the meaning of words in a writing is concerned. Where terms are used in a contract which are known and understood by a particular class of persons in a certain special or peculiar sense, evidence to that effect is admissible for the purpose of applying the instrument to its proper subject matter.... [I]n the absence of an express provision to the contrary, custom or usage, once established, is considered a part of a contract and binding on the parties though not mentioned therein, the presumption being that they knew of and contracted with reference to it.<sup>159</sup>

The distinction made between the parol evidence rule and evidence to establish custom or usage strongly supports admission of drafting history and interpretative materials.

### **b. Discovery of Drafting History & Interpretative Materials**

For the policyholder who plans to take the position that interpretative materials and drafting history serve as evidence of trade usage and course of dealing, discovery will likely become a point of contention. The broad scope of discovery, however, should resolve any issues in favor of the policyholder.

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<sup>156</sup> See *Anderson*, 756 So. 2d at 35 (“[B]ecause the limitation of liability clause is susceptible to differing interpretations, that clause is ambiguous.”); *Nat’l Merch. Co.*, 400 So. 2d at 530 (“[T]he terms are ambiguous....”).

<sup>157</sup> See *Sunbeam Corp. v. Liberty Mut. Ins. Co.*, 781 A.2d 1189 (Pa. 2001).

<sup>158</sup> *Id.* at 1193.

<sup>159</sup> *Id.* (quoting *Resolution Trust Corp. v. Urban Redevelopment Auth.*, 638 A.2d 972, 975-56 (Pa. 1994)) (alteration in original).

Interpretative materials are routinely ordered produced in coverage cases involving policy interpretation and application of policy provisions, since insurance policies are drafted by insurance industry organizations. Drafting history and interpretative materials are the best sources of information concerning interpretation of the particular provisions, like the total pollution exclusion.<sup>160</sup> The production of such materials is not a novel issue for Florida courts.

The Southern District of Florida has expressly held that the drafting history of insurance policy terms is relevant and discoverable, regardless of whether the documents are ultimately held to be admissible: “The drafting history of the policy in question and interpretations given to those terms and their interrelationship with one another are ... discoverable. Whether they will ultimately be admissible for trial is a question for another day.”<sup>161</sup>

In addition, jurisdictions that follow the same interpretive principles as Florida routinely order the production of interpretive documents.<sup>162</sup> In *Young v. Liberty Mutual Insurance Co.*,<sup>163</sup> for example, the policyholder sought production of drafting history and interpretive information. The court ordered Liberty Mutual to produce those documents.

The court based its decision on the broad scope of discovery permitted by the Federal Rules.

Relevancy should be broadly construed at the discovery stage of litigation. It must be stressed that information inadmissible at trial is still discoverable if it is reasonably calculated to lead to the discovery of admissible evidence.<sup>164</sup>

The court reviewed the principles of construction applicable to insurance policies under Connecticut law – which mirror Florida’s – and discussed the parol evidence rule. The court found that extrinsic evidence in insurance coverage cases may be relevant and admissible to “explain an ambiguity,” to prove a collateral oral agreement, to add a missing term, or to show a mistake or fraud. After a lengthy analysis, the court stated:

This case now rests at the discovery phase, where documents and materials may be discovered if they are non-privileged, relevant, and reasonably calculated to lead to admissible evidence. At this stage, the Court does not evaluate whether information ultimately will be admissible, it merely decides whether information is discoverable. To facilitate a full understanding of the meaning of an insurance policy’s terms, many courts have allowed discovery of the drafting history and interpretations of standard form CGL and Policy language. . . . [E]ven if the Court were to ultimately conclude that the CGL policies at issue were

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<sup>160</sup> See, e.g., *J.S.U.B.*, 979 So. 2d 871 (considering, as relevant to policy construction, the drafting history of CGL policies).

<sup>161</sup> *Del Monte Fresh Produce B.V. v. Ace Am. Ins. Co.*, No. 00-4792-CIV-Huck/Turnoff at 4-5 (S.D. Fla. Sept. 3, 2002) (citing *Nestle Foods Corp. v. Aetna Cas. & Sur. Co.*, 135 F.R.D. 101 (D. N.J. 1990)).

<sup>162</sup> See, e.g., *Young v. Liberty Mut. Ins. Co.*, No. 3:96-CV-1189 (EBB), 1999 WL 301688 (D. Conn. Feb. 16, 1999).

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* at \*3.

*unambiguous, this should not prevent the plaintiffs from discovering evidence which may present an ambiguity in the CGL policies at issue.*<sup>165</sup>

*Young* thus provides additional support for the discovery of pertinent materials.

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<sup>165</sup> *Id.* (internal citations omitted) (emphasis supplied).

### **Total Pollution Exclusion**

The insurance does not apply to:

1. Any Bodily Injury, Property Damage or Personal Injury arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of Pollutants anywhere in the world at any time;
2. Any loss, cost or expense arising out of any request, demand, order or statutory or regulatory requirement that the insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of Pollutants; or
3. Any loss, cost or expense arising out of any claim or Suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of Pollutants.

For the purpose of this endorsement only, Section IV. Definition is amended to include the following additional definition:

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.