

Pollution Exclusion Bars Coverage for Securities and Derivative Actions

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Applying Texas law, the United States Court of Appeals for the Fifth Circuit has held that an absolute pollution exclusion in a D&O policy barred coverage for securities and derivative litigation alleging that the company and its directors and officers concealed information from the public concerning the company's illegal waste disposal activities. *Nat'l Union Fire Ins. Co. v. U.S. Liquids, Inc.*, 2004 WL 304084 (5th Cir. Feb. 17, 2004).

The coverage dispute arose from a consolidated securities action and shareholder derivative suit filed against a company that provided waste management services and its directors and officers. The underlying litigation alleged that the company acquired numerous waste management businesses "without regard to or disclosure of these companies' improper waste disposal practices." The complaints alleged that after the FBI investigated and shut down part of one of the company's plants, the company's concealment of illegal waste disposal practices came to light and the price of the company's stock tumbled.

The company previously had purchased a D&O policy that included a "Securities Plus II" endorsement providing coverage for securities claims, including those "based upon or attributable to, in part or in whole, the purchase or sale, or offer or solicitation of an offer to purchase or sell, any securities" of the company, and any class or derivative claims "alleging any Wrongful Act of an Insured." The policy also included an absolute pollution exclusion precluding coverage for loss arising from a claim "alleging, arising out of, based upon, attributable to, or in any way involving, directly or indirectly: (1) the actual, alleged or threatened discharge, dispersal, release or escape of pollutants; or (2) any direction or request to test for, monitor, clean up...or neutralize pollutants..." The exclusion also included, but was not limited to, claims "alleging damage to the Company or its security holders." The policy specified that the definition of "claim" included "securities claim." Finally, the policy provided for the advancement of defense costs prior to the final disposition of a suit, and specifically stated that "the Insurer does not...assume any duty to defend."

The court first rejected the company's argument that the securities endorsement and pollution exclusion were ambiguous as applied to the securities and derivative litigation. The court concluded that the "the terms of the Policy's pollution exclusion were clear and neither patently nor latently ambiguous." Next, the court held that the pollution exclusion precluded coverage for the securities action and the derivative suit. The court reasoned that the "arising out of" language in the pollution exclusion required a "but for" causal relationship, and that this standard governed "the broadly worded pollution exclusion." In so doing, the court rejected the

company's argument that the Texas Supreme Court had rejected the "but for" test in *King v. Dallas Fire Insurance Co.*, 85 S.W.3d 185 (Tex. 2002). The court distinguished *King* on the grounds that it was "limited to the situation where a policy contains an 'occurrence' requirement that must be triggered before an employer can be covered for an employee's intentional actions." Because "the losses described in the factual allegations of the securities and derivative suits bore more than an incidental relationship to the broad polluting conduct excluded in the Policy and that 'but for' such illegal activities those underlying claims would not exist," the court concluded that the pollution exclusion barred coverage for the securities and derivative suits.

Finally, the court determined that the insurer had no duty to advance defense costs to the company for the litigation because the pollution exclusion precluded coverage. The court reasoned that the insurer had no obligation to make any payment for loss arising from an uncovered claim and that the policy provided that loss included defense costs.

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