

STATE OF MICHIGAN
IN THE SUPREME COURT

Appeal from the Michigan Court of Appeals
The Hon. Peter D. O'Connell, Stephen L. Borrello, and Elizabeth L. Gleicher

CHARLIE B. HOBSON and
MARY L. HOBSON, husband and wife,

Supreme Court No. 151447

Plaintiffs-Appellees,

Court of Appeals No. 316714

v

Lower Court No. 12-008167-CK

INDIAN HARBOR INSURANCE COMPANY, a
foreign corp., XL INSURANCE AMERICA, INC.,
a foreign corp., and XL INSURANCE COMPANY OF
NEW YORK, INC., a foreign corp.,

Defendants-Appellants,
-and-

**DEFENDANTS-APPELLANTS
XL INSURANCE, ET AL.S'
REPLY TO PLAINTFFS-
APPELLEES' ANSWER TO
APPLICATION FOR LEAVE
TO APPEAL**

WILSON INVESTMENT SERVICE AND CONSTRUCTION, INC.,
WILSON INVESTMENT SERVICE, CRESCENT HOUSE APARTMENTS,
CRESCENT HOUSE APARTMENTS, LLC, W-4 FAMILY LIMITED
PARTNERSHIP, W-4 FAMILY, LLC and JAMES P. WILSON,

Defendants-Appellees.

EDMUND O. BATTERSBY (P 35660)
SAMUEL I. BERNSTEIN (P 10745)
Attorneys for Plaintiffs-Appellees Hobsons
31731 Northwestern Highway, #333
Farmington Hills, MI 48334
(248) 737-8400
ebattersby@sambernstein.com

MARK R. BENDURE (P 23490)
Appellate Counsel for Plaintiffs-Appellees Hobsons
645 Griswold, Suite 4100
Detroit, MI 48226
(313) 961-1525
bendurelaw@cs.com

MARK E. MORLEY (P 17971)
DREW BROADDUS (P 64658)
Attorneys for Defendants-Appellants Indian
Harbor Ins. Co., XL Ins. America. Inc., and
XL Ins. Co. of New York
2600 Troy Center Drive, P.O. Box 5025
Troy, MI 48007-5025
(616) 272-7966
dbroadus@secrestwardle.com

FRANCIS W. HIGGINS (P 28111)
Attorney for Defendants-Appellees Wilson
Investment, Crescent House Apartments Crescent
House Apartments, LLC, W-4 Family Limited
Partnership, W-4 Family, LLC and James Wilson
2799 Coolidge Highway
Berkley, MI 48072
(248) 541-5575
mhlawmichigan@aol.com

TABLE OF CONTENTS

Index of Authorities	ii
Argument	1
Conclusion and Request for Relief	10

INDEX OF AUTHORITIES**CASES**

<i>American Bumper & Mfg Co v Hartford Fire Ins Co</i> , 452 Mich 440; 550 NW2d 475 (1996)	10
<i>Apana v TIG Ins Co</i> , 574 F3d 679 (9 th Cir 2009)	2
<i>Besic v Citizens Ins Co of the Midwest</i> , 290 Mich App 19; 800 NW2d 93 (2010)	3
<i>Church Mut Ins Co v Clay Center Christian Church</i> , 746 F3d 375 (8 th Cir 2014)	9
<i>DeFrain v State Farm Mut Auto Ins Co</i> , 491 Mich 359; 817 NW2d 504 (2012)	2
<i>Devillers v Auto Club Ins Ass'n</i> , 473 Mich 562; 702 NW2d 539 (2005)	4,10
<i>Exxon Shipping Co v Baker</i> , 554 US 471; 128 S Ct 2605 (2008)	7
<i>Hayley v Allstate Ins Co</i> , 262 Mich App 571; 686 NW2d 273 (2004)	6
<i>Holiday Hospitality Franchising, Inc v AMCO Ins Co</i> , 983 NE2d 574 (Ind 2013)	8
<i>Hunt v Drielick</i> , 496 Mich 366; 852 NW2d 562 (2014)	7
<i>Ile v Foremost Ins Co</i> , 493 Mich 915; 823 NW2d 426 (2012)	1,2
<i>Iroquois on the Beach, Inc v General Star Indem Co</i> , 550 F3d 585 (6 th Cir 2008)	7
<i>McKusick v Travelers Indem Co</i> , 246 Mich App 329; 632 NW2d 525 (2001)	2
<i>Rory v Continental Ins Co</i> , 473 Mich 457; 703 NW2d 23 (2005)	2,9

<i>Valassis Communications v Aetna Cas & Sur Co</i> , 97 F3d 870 (6 th Cir 1996)	3
<i>Vanguard Ins Co v Clarke</i> , 438 Mich 463; 475 NW2d 48 (1991)	6
<i>Whitt Mach, Inc v Essex Ins Co</i> , 377 Fed Appx 492 (6 th Cir 2010)	3
<i>Wilburn v Commonwealth</i> , 312 SW3d 321 (Ky 2010)	10
<i>Wilkie v Auto-Owners Insurance Co</i> , 469 Mich 41; 664 NW2d 776 (2003)	6
 <u>COURT RULES</u>	
MCR 7.302(B)(3)	1,2
MCR 7.302(B)(5)	1,2

ARGUMENT

Plaintiffs-Appellees Charlie and Mary Hobson (“Plaintiffs”) argue that the Application filed by Defendants-Appellants XL Insurance et al. (“XL Insurance”) does not present an issue that “warrant[s] extraordinary review by a Supreme Court of last resort.” (Answer to Application, p 10.) However, as XL Insurance explained in its Application, this case does in fact satisfy MCR 7.302(B)(3) and (B)(5), as the lower courts’ rulings are directly at odds with this Court’s precedent. In denying XL Insurance’s motion, the lower courts invoked some form of the “doctrine of illusory coverage.” (Ex. 10 attached to Answer to Application, pp 14-15.) In *Ile v Foremost Ins Co*, 493 Mich 915; 823 NW2d 426 (2012) this Court “expressly rejected the notion that the perceived expectations of a party may override the clear language of a contract.”

Here, the trial court commented: “Why would this person buy your insurance? ... That’s an absurd result in reading this policy. They couldn’t have intended this when you have this total pollution exclusion....” (Ex. 10 attached to Answer to Application, pp 14-15.) In affirming this holding (although perhaps not for the same reasons), the Court of Appeals conflated smoke with fire (Ex. 1 attached to Answer to Application, p 6), and essentially reasoned that a pollution exclusion just could not apply to these facts, regardless of its language. The panel placed unwarranted emphasis on the historic “impetus behind pollution exclusion clauses similar to the one at issue” (Id., p 5) – rather than the policy language – and determined that XL Insurance’s position would “extend the scope of the pollution exclusion beyond the scope of its original intent....” (Id., p 6.) Ultimately, the panel found that pollution exclusions only apply to “‘occurrences’ involving the pollutant as a pollutant” (Id., p 7) – in other words,

the panel inserted a limitation into the exclusion, in direct contradiction to *McKusick v Travelers Indem Co*, 246 Mich App 329; 632 NW2d 525 (2001),¹ which the panel was bound to follow.

This Court's holding in *Ile* makes clear that the perceived expectations of a party – which the trial court apparently looked to – *may not* override unambiguous policy language. Indeed, the error was even more apparent here, as the insured had no reasonable expectation of coverage for “smoke” or “soot” damages flowing from a fire, where a “hostile fire” exception to the pollution exclusion had been expressly and unambiguously *removed* from the policy by the Total Pollution Exclusion Endorsement. Following this Court's decision in *Ile*, a policy cannot be illusory when there are circumstances where the insured's coverage could be triggered. Here, in denying XL Insurance's motion, the trial court acknowledged at least one such circumstance – if the underlying tort claimants had suffered burns. (Ex. 10 attached to Answer to Application, pp 14-15.) Nonetheless, the trial court refused to apply the Total Pollution Exclusion, finding that doing so would be “absurd” (*Id.*), and the Court of Appeals affirmed that result. Therefore, this Court's review is necessary in order to ensure that the bench and bar have sufficient guidance on the meaning of *Ile* and the status of the “doctrine of illusory coverage” in this State's jurisprudence. The requirements of MCR 7.302(B)(3) & (B)(5) are also satisfied because the lower court's holding was contrary to other precedents of this Court, particularly *DeFrain v State Farm Mut Auto Ins Co*, 491 Mich 359, 366-367; 817 NW2d 504 (2012) and *Rory v Continental Ins Co*, 473 Mich 457, 461; 703 NW2d 23 (2005).

¹ “The scope of the total pollution exclusion has been repeatedly litigated, spawning conflicting judicial decisions throughout the country.” *Apana v TIG Ins Co*, 574 F3d 679, 682 (9th Cir 2009). “Most state courts fall roughly into one of two broad camps.” *Id.* “Some courts apply the exclusion literally....” *Id.* “Other courts have limited the exclusion to situations involving traditional environmental pollution....” *Id.* Michigan falls within the first camp, i.e., states that “apply the exclusion literally.” See *Id.*, citing *McKusick*.

Turning to Plaintiffs' substantive arguments, Plaintiff leads off with an argument that the Court of Appeals did not rely upon, and that Plaintiff did not raise in the trial court: that the XL Insurance policy is ambiguous because the Total Pollution Exclusion Endorsement supposedly conflicts with the pollution exclusion that appears "in the body of the insurance policy" (which contains the "hostile fire" exception). (Answer to Application, pp 13-16.) While the argument has some surface appeal – it does appear, upon a superficial examination of the policy, that there are two pollution exclusions – it fails because the exclusion "in the body of the policy" *was completely superseded, nullified, and erased* by the Total Pollution Exclusion Endorsement and therefore, there is no conflict and no ambiguity. See *Besic v Citizens Ins Co of the Midwest*, 290 Mich App 19, 26; 800 NW2d 93 (2010). As discussed in the Application, "[i]nsurance contract law ... dictates that when an endorsement deletes language from a policy, a court must not consider the deleted language in its interpretation of the remaining agreement." *Valassis Communications v Aetna Cas & Sur Co*, 97 F3d 870, 873 (6th Cir 1996) (applying Michigan law in diversity). "Endorsements by their very nature are designed to trump general policy provisions, and where a conflict exists between the provisions of the main policy and the endorsement, the endorsement prevails." *Besic*, 290 Mich App at 26. Therefore, under well-established principles of insurance policy interpretation, the pollution exclusion "in the body of the policy" *simply was not part of the analysis*, given the elimination of the "hostile file" language in the endorsement. The old pollution exclusion cannot conflict with anything because it ceased to be a part of the policy once the endorsement was issued.²

² "When an endorsement conflicts with an insurance contract, the endorsement controls." *Whitt Mach, Inc v Essex Ins Co*, 631 F Supp 2d 927, 934-935 (SD Ohio 2009).

Although the Court of Appeals did not adopt Plaintiffs' ambiguity argument, the argument does reveal a fundamental misapprehension of how the endorsement operated. And this misapprehension seeped into the Court of Appeals' reasoning, even if Plaintiff's position regarding ambiguity did not. The pollution exclusion originally said: "this subparagraph does not apply to ... (iii) 'bodily injury' or 'property damage' arising out of heat, smoke or fumes from a 'hostile fire'...." (Ex. F attached to Application.) But the Total Pollution Exclusion *Endorsement* specifically removed this language. (Id.) By treating smoke as the same thing as fire, the panel effectively wrote the "hostile fire" exception *back into* the Total Pollution Exclusion, even though that exception to the exclusion had been "clearly" removed by an endorsement "before the alleged injuries occurred." (Ex. 1 attached to Answer to Application, p 2 n 2.)³ Indeed, both of the lower courts started from the unstated assumption that there was a "hostile fire" exception to the pollution exclusion – despite the plain language of the endorsement⁴ – based on Plaintiffs' assertion that such an exception would have been reasonable.

Plaintiffs next invoke the reasoning of Judge O'Connell's concurrence, arguing that "the pollution exclusion does not apply to fire claims on rental premises." (Answer to Application, p 16.) Plaintiff never took this position in the trial court, in the Court of Appeals, or in response to XL Insurance's first Application to this Court in 2014. And for good reason. As XL Insurance explained in its Application, Section I—Coverages, 2. Exclusions, on the fifth page of the policy, provides that "[e]xclusions c. through n. do not apply to damage by fire to

³ Moreover, by conflating smoke with fire, the Court of Appeals contravened the long-standing principle that "contractual language must be enforced according to its plain meaning, and cannot be judicially revised or amended to harmonize with the prevailing whims of members of [the court]." *Devillers v Auto Club Ins Ass'n*, 473 Mich 562, 582; 702 NW2d 539 (2005).

⁴ Again, the Court of Appeals initially acknowledged that the "hostile fire" exception had "no bearing in this case" (Ex. 1 attached to Answer to Application, p 2 n 2), but then found that the exclusion could not apply, essentially because there was a hostile fire (Id., p 6).

premises while rented to you or temporarily occupied by you with the permission of the owner.” (Ex. 1 attached to Answer to Application, concurring opinion, p 2.) Since the Total Pollution Exclusion is exclusion f., this language supposedly (in the eyes of Judge O’Connell) negated XL Insurance’s ability to invoke that exclusion. Simply put, **the language invoked sua sponte by Judge O’Connell is inapplicable to this case** because it only applies to “premises ... rented to” *the insured* or “temporarily occupied by” *the insured*, “with the permission of the owner.” The word “you” as used in this section refers to the named insured, Defendants Wilson, not to third-party tort claimants such as these Plaintiffs. Defendants Wilson owned the apartment complex in question; there is nothing in the record suggesting that the complex was rented to the Defendants Wilson or occupied by the Defendants Wilson with the permission of some other entity. (See Ex. 1 attached to Answer to Application, p 2, citing Plaintiffs’ complaint.) Judge O’Connell oversimplified this provision by opining that “exclusion f. does not apply in this case because the Hobsons’ claim concerns ‘damage by fire to premises,’” without giving consideration to the rest of the clause (i.e., “premises ... *rented to you or temporarily occupied by you...*”). The fact that the insured owned the premises negates this exception to the pollution exclusion (which may explain why Plaintiffs never raised this argument).⁵

Plaintiffs next argue that “even if the endorsement relied on by” XL Insurance “applied, the Complaint alleges injuries covered by the policy.” (Answer to Application, p 17.) The gist of this argument is that because the Plaintiffs’ claim was really predicated on the negligence of “the insured’s employees” rather than inhaling smoke, the loss is covered. (Id., p 18.) Plaintiff’s position in this regard rests entirely upon the reasoning of the Court of Appeals, which seemingly

⁵ Judge O’Connell’s concurrence also makes the same error as the majority: conflating smoke with fire. (Ex. 1 attached to Answer to Application, concurring opinion, p 1.)

acknowledged that the Plaintiffs allegedly suffered smoke inhalation injuries (Ex. 1 attached to Answer to Application, pp 3, 6), that the Plaintiffs did not claim to have been burned (Id.), that the policy defined “pollutants” to include smoke and soot (Id., p 5), and that the policy contained an exclusion for “bodily injury ... which would not have occurred in whole *or in part* but for the actual, alleged, or threatened discharge, dispersal, seepage, migration, release or escape of ‘pollutants’ at any time.” (Id., p 4, emphasis added.) However, the panel looked past the nature of the injuries alleged by the Plaintiffs, and instead characterized their claim as being about “the negligence of the insured” in starting the fire. (Id.) In so doing, the panel ignored the longstanding principle that “[c]overage under a policy is lost if any exclusion in the policy applies to an insured's particular claims.” *Hayley v Allstate Ins Co*, 262 Mich App 571, 574; 686 NW2d 273 (2004). In *Vanguard Ins Co v Clarke*, 438 Mich 463, 470; 475 NW2d 48 (1991),⁶ this Court rejected the concept of “dual causation,” in the context of coverage issues. In other words, if an injury flows in part from a covered occurrence, and in part from an excluded occurrence, the policy exclusion will control.

Here, it is undisputed that the applicable policy contains an exclusion for “[b]odily injury” or “property damage” which “would not have occurred in whole or part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of ‘pollutants’ at any time.” Elsewhere in the policy, the term “pollutants” is defined as “any solid, liquid, gaseous or thermal irritant or contaminant, *including smoke ... [and] soot...*” (Ex. B attached to Application, emphasis added.) The Plaintiffs alleged “smoke inhalation injuries.” (Ex. C attached to Application, ¶¶ 10, 11.) *Vanguard's* discussion of dual causation is therefore relevant because, even if the Plaintiffs’ claim could be characterized as simply one for

⁶ Overruled on other grounds by *Wilkie v Auto-Owners Ins*, 469 Mich 41; 664 NW2d 776 (2003).

“negligence,” the result cannot be reconciled with Michigan law as articulated in *Iroquois on the Beach, Inc v General Star Indem Co*, 550 F3d 585, 588 (6th Cir 2008) (“the default rule under Michigan law is that a loss is not covered when it is concurrently caused by the combination of a covered cause and an excluded cause”).

Moreover, the *Hobson* panel’s analysis in this regard (Answer to Application, pp 17-18) runs the risk of nullifying all pollution exclusions – and perhaps many other kinds of exclusions – since almost every occurrence can in some way be traced to someone’s negligence. (See, for example, Ex. 2 attached to Answer to Application, p 39, defining an “occurrence” as “an accident.”) Even a “traditional environmental harm” which “the pollution exclusion clause was designed to exclude coverage for” (Ex. 1 attached to Answer to Application, p 7) such as the grounding of the *Exxon Valdez* supertanker in 1989 could, under the panel’s reasoning, simply be re-characterized as *really being* a claim for the negligence of the ship’s captain, as opposed to a claim for the seepage, release, or discharge of 53 million gallons of crude oil.⁷ If that were the case, it would be as if the pollution exclusion did not exist at all. But that is not the law of this State. *Hunt v Drielick*, 496 Mich 366, 372-373; 852 NW2d 562 (2014) (“clear and specific exclusions must be enforced....”). And the problems with the *Hobson* panel’s reasoning do not end with pollution exclusions. An exclusion for “liquor liability,” for example (Ex. 2 attached to Answer to Application, p 28), could be avoided simply by saying that an employee of the insured served the liquor negligently. An exclusion for “electronic data” (*Id.*, p 31) could be nullified simply saying that the claim really isn’t for lost data but rather, for the insured’s employee’s negligence in deleting it. And so forth.

⁷ See *Exxon Shipping Co v Baker*, 554 US 471, 476-477; 128 S Ct 2605 (2008).

Plaintiffs also argue that the exclusion is inapplicable because there was no “discharge, dispersal, seepage, migration, release or escape of a pollutant.” (Answer to Application, p 18.) The panel adopted this argument. But it bears repeating that the exclusion uses the word “or,” meaning the list is disjunctive and any one of the six events listed (a discharge, dispersal, seepage, migration, release, *or* escape) will trigger the exclusion. See *Holiday Hospitality Franchising, Inc v AMCO Ins Co*, 983 NE2d 574, 579 (Ind 2013). Plaintiffs’ argument in this respect falls apart when one observes that these words have multiple, generally accepted meanings. For example, one of the dictionary definitions of “disperse” is “to cause to become spread widely.” (Ex. G-12 attached to Application, definition of “disperse,” p 1 of 5.) There is little doubt that fire causes smoke “to become spread widely.” Likewise, one of the definitions of “migrate” is “to change position in ... [a] substance.” (Id., definition of “migrate,” p 1 of 3.) This is precisely what fire does: causes smoke to migrate through the air. Also, Merriam-Webster’s definition of “release” includes, as an example, “the release of heat into the atmosphere.” (Id., definition of “release,” p 3 of 5.) Again, fire releases both smoke and heat into the atmosphere. Indeed, if a fire could not by its very nature cause a “discharge, dispersal, seepage, migration, release, or escape” as Plaintiffs assert (Answer to Application, p 19), then the *rescinded* “hostile fire” exception that originally appeared in the policy would have been completely useless because, under Plaintiffs’ reasoning, a hostile fire could never implicate the pollution exclusion in the first place. In short, if the pollution exclusion required that the pollutant first be contained – and then somehow break free of its containment – before the exclusion could apply, then the policy easily could have said so. It does not.

To a large extent, Plaintiffs’ argument – that a pollutant first had to be “contained” in order for the exclusion to apply – seems to flow from the tacit assumption that the pollution

exclusion should only apply to traditional environmental incidents. Although not squarely addressed in Michigan case law, numerous courts throughout the United States have held that pollution exclusions *are not* limited to “traditional environmental damage.” As the Eighth Circuit recently noted, “although the pollution exclusion was ‘quite broad,’ it was unambiguous and was not limited to traditional environmental damage.” *Church Mut Ins Co v Clay Center Christian Church*, 746 F3d 375, 380 (8th Cir 2014) (citation omitted). The panel further observed that a “majority of state and federal jurisdictions have held that absolute pollution exclusions are unambiguous as a matter of law and, thus, exclude coverage for all claims alleging damage caused by pollutants.” *Id.* (citation omitted). Additionally, in a statement that could have been in direct response to the trial judge’s comments here, the panel noted that “[t]he broad nature of the pollution exclusion may cause a commercial client to question the value of portions of its commercial general liability policy, but, as an appellate court reviewing terms of an insurance contract, we cannot say that the language of the pollution exclusion is ambiguous in any way.” *Id.* Such an approach is consistent with, if not mandated by, our Supreme Court’s holding in *Rory*, 473 Mich at 470 that an unambiguous insurance policy provision “is to be enforced as written” irrespective of any “judicial assessment of ‘reasonableness’”

Plaintiffs conclude with a discussion about how XL Insurance purportedly breached its duty to defend. (Answer to Application, p 20.) This is a strange argument to make, because these Plaintiffs were not the named insureds and were not owed a defense in the underlying tort case! Even if XL Insurance breached the broader duty to defend, it would not necessarily entitle the Hobsons to anything, since the duty to defend would have been owed to XL’s insured (Wilson, et al.), *not* these Plaintiffs. Also, Plaintiffs acknowledge that the duty to defend is *broader* than the duty to indemnify. (Ex. G attached to Application, p 8.) Moreover, Plaintiffs’

entire discussion of the duty to defend “begs the question” by assuming the very thing that they sought to prove, i.e. that this was a covered loss.⁸

CONCLUSION AND REQUEST FOR RELIEF

The lower courts’ denial of XL Insurance’s Motion for Summary Disposition was in direct conflict with multiple precedents of this Court. By conflating smoke with fire, the Court of Appeals contravened the long-standing principle that “contractual language must be enforced according to its plain meaning, and cannot be judicially revised or amended to harmonize with the prevailing whims of members of [the court].” *Devillers*, 473 Mich at 582. And by treating smoke as the same thing as fire, the panel effectively wrote the “hostile fire” exception *back into* the Total Pollution Exclusion, even though that exception to the exclusion had been “clearly” removed by an endorsement “before the alleged injuries occurred.” (Ex. 1 attached to Answer to Application, p 2 n 2.) For these reasons, XL Insurance respectfully requests that this Honorable Supreme Court grant the relief sought in XL Insurance’s Application.

SECRET WARDLE

BY: /s/Drew W. Broaddus
 DREW W. BROADDUS (P 64658)
 Attorney for Defendant-Appellant XL Insurance
 2600 Troy Center Drive, P.O. Box 5025
 Troy, MI 48007-5025
 (616) 272-7966
dbroaddus@secrestwardle.com

Dated: June 16, 2015
 3103998_2

⁸ “[T]he duty to defend is related to the duty to indemnify in that it arises only with respect to insurance afforded by the policy. *If the policy does not apply, there is no duty to defend.*” *American Bumper & Mfg Co v Hartford Fire Ins Co*, 452 Mich 440, 450; 550 NW2d 475 (1996) (emphasis added). Therefore, Plaintiffs’ argument regarding the duty to defend commits the “fallacy of begging the question,” which “consists in taking for granted precisely what is in dispute, in passing off as an argument what is really no more than an assertion of your position.” *Wilburn v Commonwealth*, 312 SW3d 321, 334 (Ky 2010) (Noble, J., dissenting).