**Some Common Coverage Misconceptions of the CGL Policy**
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We have all heard the horror stories of outrageous coverage denials by insurers or equally wild representations of coverage by insurance sales personnel. At any gathering of insurance or risk management professionals, new unbelievable stories are sure to emerge. Yet, more often than not, the stories are really the same or similar to past stories; only the names and times have changed.

Considering this and other experiences in my 2.5+ decades in insurance and risk management, I have come to believe that there are some fundamental misunderstandings about how insurance works. I don't mean to suggest that there is a magic approach that will clarify everything—some policies, like the commercial general liability policy, are difficult to understand.

However, there are some ground rules that are helpful to understand and observe. For example, all insurance coverage interpretation is not purely subjective opinion. On the contrary, most jurisdictions view the interpretation of an insurance policy as a matter of law, often with clearly articulated rulings as to the meaning of certain policy wording. In addition, most courts follow certain rules of "construction" in interpreting an insurance policy.

All of this is to say that the policy wording is important. Policies must be read carefully in their entirety to be understood. Coverage is usually interpreted not by a collective understanding (or misunderstanding) of a policy, but by a thoughtful reading of the *actual* policy wording (this is what courts generally attempt in their interpretation). To expect an insurer to "do the right thing" and pay a claim where coverage does not exist is dicey at best—usually a losing proposition when the stakes (or the claim) escalates.

This article addresses some areas of the Insurance Services Office, Inc. (ISO) CGL policy (October 2001 edition) that I think are most commonly misunderstood. While I will not claim that my illustrations will apply in all circumstances, I suggest that my comments are worthy of consideration before determining how the CGL applies. As there are always exceptions to every rule, I am sure there are situations in which the general principles I am espousing do not apply. Nonetheless, if thought is stimulated and understanding enhanced, then this has been a worthwhile exercise.

**When Does the Duty To Defend End?**

When a catastrophic event occurs, invariably someone will insist that the CGL insurer should just write a check for the limit, deposit it with the clerk of courts, and wash their hands of the claim. In other words, they should just get out.

The Station Nightclub fire in West Warwick, Rhode Island, that occurred in February 2003, in which 100 people died and many others (about 200) were injured, is a tragic and very sad case in point. The rumor is that the nightclub has a $1 million per occurrence CGL limit. Assuming this is true, can the insurer simply write a check for $1 million and refuse to defend? It appears the damages resulting from the injuries and deaths will far exceed $1 million.

The wording of the ISO CGL policy will *not* allow the insurer to simply tender its limit and not defend any insured. The insurer's duty to defend does not end until the applicable limit has been used *in the payment of judgment or settlement*. In other words, an insured has a right to be defended against any "suit" alleging damages arising out of covered bodily injury or property damage unless and until the full limit is paid via a settlement or settlements or pursuant to a judgment for damages. And if a standard ISO CGL policy is providing coverage, the costs of such defense are payable *in addition to the policy limit* with no dollar limitation.

However, due to the magnitude of The Station disaster, it will be instructive to see how the courts will handle the civil proceedings. Will the first person to settle recover most or all of the insurance limit, leaving little or no insurance available for other victims? Can the insurer seek out a family or person most likely to settle, pay their limit, and extinguish their duty to defend? What will the courts allow? This is, as yet, an unanswered question.

It is also worth noting that Rhode Island's attorney general brought charges of gross criminal negligence (among other charges) against the nightclub owners. As these charges are criminal in nature, the insurer has no duty to defend the owners/insureds against these charges (even though "negligence" appears in the allegation) as the duty to defend only applies to civil proceedings, not to criminal charges.

**The CGL Is Triggered by an "Occurrence"**

Labeled an "occurrence"-based CGL policy since 1985, it is a common belief that an "occurrence" triggers coverage. A closer reading of the CGL insuring agreement reveals that the CGL only applies if the bodily injury or property damage is caused by an "occurrence" which takes place in the "policy territory," but *only if the bodily injury or property damage occurs during the policy period.*

While this seems simple enough, the implications are quite far ranging. Here is a simple example that usually raises an eyebrow or two among insurance professionals. Assume a sole proprietor has his occurrence-based CGL policy continuously with the same insurer since 1993. The sole proprietor is a builder constructing one-family homes, doing the carpentry work himself. In 2003 he has met his financial goals and decides to retire, canceling his CGL policy in December of 2003.

A home he built in late 2002 has a problem: he used the wrong material to secure the floor, which eventually weakened and collapsed in early 2004, severely injuring the occupant at the time of the collapse. The injured party sues the sole proprietor/builder for her injuries. Does the builder have any CGL coverage?

A common response is that the insurer writing the CGL coverage in 2002, the time the floor was incorrectly installed, should defend the sole proprietor and pay damages because of the bodily injury if he is legally liable. Unfortunately for the builder, the policy does not obligate the insurer to respond in any way because the bodily injury did not occur during the policy period.

**The Infamous "Tail."** The next most common response (which I have heard from attorneys and accountants in addition to insurance professionals), is that the builder should have bought "tail" coverage. As this is an occurrence policy, a tail is not available to purchase. Even if the builder had a claims-made CGL policy and purchased the tail, the policy would not respond to bodily injuries that take place *after* the policy expired and *during* the tail or "Supplemental Extended Reporting Period." The tail provides coverage only for injuries and damages that occurred *prior* to the purchase of the tail but for which a claim is made against the insured *during* the tail period.

**Discontinued Completed Operations.** The discontinued operations policy is simply a standard CGL policy rated to reflect the diminishing liability loss exposures of the person or organization. If the builder had simply continued to purchase his CGL policy as he had for the past 10 years, the effect would have been the same.

Would the insurer that wrote the builder's CGL for the past 10 years be willing to offer the discontinued completed operations policy? Even though the exposure has not changed (it is actually reducing—there is no more operations exposure) during the discontinued phase of the policy, they probably would not.

In the buying and selling of businesses, understanding this seemingly simple concept is crucial. Had the same builder sold his business (its assets or possibly the stock if he was incorporated), the builder may still have need for the discontinued completed operations policy. Yet, it would be mildly surprising to see accountants and lawyers recognize this and suggest such coverage to the builder.

**Punitive Damages**

Does the ISO CGL policy include coverage for the payment of punitive damages? My experience is that about half of the people to whom I pose this question answer "No, the CGL does will not pay for such damages."

There is a difference between an insurer's obligation to pay according to the policy terms and a legal prohibition against the payment of punitive damages. Some jurisdictions will not allow insurers to pay punitive damages as such payments have been found to be against public policy. Other jurisdictions have statutes with similar prohibitions.

As the CGL insuring agreement does obligate an insurer to pay "as damages" those sums an insured is legally obligated to pay because of bodily injury or property damage, the simple answer to the question is, "Yes, the ISO CGL does obligate the insurer to pay punitive damages." Legal prohibition of paying punitive forbids the insurer from discharging an obligation otherwise included in the CGL policy. But the obligation is clear—the insuring agreement is not restricted to compensatory damages and thus includes all damages, including punitive damages.

**Exclusionary Wording.** If an insurer endorses the CGL to exclude punitive damages (a common practice among non-admitted insurers), then the answer becomes a very clear "No." Punitive damages are excluded, and there is no need to look beyond the policy to issues of legality and enforceability; there is no coverage for punitive damages.

The courts of the Commonwealth of Massachusetts apparently have not definitively ruled on whether punitive damages can be paid by an insurer—which prompted an insurer's claim person to emphatically tell me punitive damages are definitely not covered by the ISO CGL as their defense counsel advised them the issue was unsettled. I think the person missed the distinction.

**Damage to "Your Work" Exclusion**

The property damage exclusion applying to "your work" is sometimes applied more broadly than is warranted by the policy wording. The exclusion only applies if the damage to "your work" arises out of your work *and* is included within the products-completed operations hazard.

As an illustration, assume a contractor adds a downstairs bathroom to a customer's home. Everyone is pleased with the work, so much so that 2 years later the homeowner decides to have the contractor remodel the upstairs family room. Just as the work on the family room gets underway, the contractor negligently causes a small electrical fire, which, in part, damages the downstairs bathroom.

Is the downstairs bathroom the contractor's work? Is there property damage to the contractor's work? The obvious answer to both questions is, "Yes." Is the damage caused to the downstairs bathroom excluded by the "your work" exclusion? Too frequently we see insurers automatically invoke the "your work" exclusion and deny coverage.

The error made by the insurer in the above denial is the damage to the customer's bathroom *did not arise out of the completed work*—the bathroom. The cause of the damage was the work being done (present tense) on the family room, not the bathroom. The family room should not be considered "your work" as respects the contractor as the work had not been completed (and thus not included within the products-completed operations hazard). Therefore, the property damage did not *arise* out of "your work" or any part of it.

The contractor *does* have coverage for the property damage to the previously completed bathroom, but may not have coverage for portions of the family room (via a different property damage exclusion).

**Street Sweepers Are *Not* Mobile Equipment**

It is not uncommon for insurers to write coverage for damage to self-propelled street sweeping equipment as inland marine coverage. This sometimes leads to the erroneous conclusion that street sweeping equipment is mobile equipment, and thus liability coverage is provided by the CGL for any claims arising out of the equipment's operation, maintenance, or use (including loading and unloading).

Self-propelled equipment designed for street sweeping and other self-propelled road maintenance equipment is addressed in the CGL and is clearly considered to be an auto. Any liability arising out of autos owned, operated by, rented to, or loaned to any insured is *not* covered by the CGL. Coverage must be obtained via an auto policy.

**Newly Acquired or Formed Entities**

This clause of the CGL has to be fully understood so as not to provide policyholders a false sense of security. The coverage provided to new entities either formed or acquired is actually quite limited. Consider just a couple of the following restrictions.

**Limited Liability Companies.** Any joint ventures, partnerships, or limited liability companies formed or acquired by a named insured are not automatically included as *named insureds*. Such entities must be listed on the policy as named insureds *immediately* to be covered. Limited liability companies are increasing in popularity as they are easy and inexpensive to form. The likelihood of having a newly formed entity not covered by the CGL increases with the popularity of the limited liability company.

**The Entrepreneur.** The new entity must be formed or acquired by a *named insured*. It is common for an entrepreneur to own multiple corporations. If ABC, Inc., is the named insured and is 100 percent owned by Jack Armstrong, only entities formed or acquired by ABC, Inc., will receive any benefit from the newly acquired or formed entity wording.

If Jack Armstrong purchases 100 percent of the shares of XYZ, Inc., there is *no* automatic coverage for this newly acquired named insured as XYZ, Inc., was acquired by Jack Armstrong and not ABC, Inc. Determining who owns what is often a tedious, sometimes futile task, but may make a very big difference in how coverage applies.

**Excluding Products/Completed Operations Coverage**

Certain CGL classifications, such as "Buildings or Premises—Bank, Office or Mercantile (Lessor's Risk Only)," have a corresponding note in the *Commercial Lines Manual* that reads "Products/Completed Operations Included." Such a classification, when properly described on the CGL declarations page, will also note products/completed operations are "Subject to the General Aggregate Limit."

The state "Loss Cost" pages will not show any *separate* loss costs for Subline Code 336, products/completed operations for these classification codes. Hence, there is no additional charge for products/completed operations coverage for this and similar classifications. The cost of this products/completed operations exposure, however remote, is *included* within Subline Code 334, premises/operations charge.

Historically, some insurers translate "included" to mean "no coverage" and have proceeded to exclude products and completed operations coverage and attach the exclusionary endorsement (CG 21 04—Exclusion—Products-Completed Operations Hazard), eliminating coverage for any bodily injury or property damage included within the products/completed operations hazard (as defined in the policy). Unless the insurer intends to exclude the products/completed operations hazard for *other* classifications listed on the policy, this exclusion is ineffective.

The definition in the CGL for the "products/completed operations hazard" includes three exceptions. The third exception states that:

Products-completed operations hazard … Does not include "bodily injury" or "property damage" arising out of: …

(3) Products or operations for which the classification, listed in the Declarations or in a policy schedule, states that the products-completed operations are subject to the General Aggregate Limit.

In short, any claim that would normally be considered a product or completed operation is *not* considered included within the products/completed operations hazard and thus Exclusion CG 21 04 does not apply to claims arising out of this classification.

**Illustration.** Assume a janitorial service was hired to clean the kitchen and storage area of a restaurant. Unfortunately, the service did not adequately clean the floor of the food storage area. The day after the cleaning was complete, an employee of the restaurant slipped and fell on a chicken bone, and subsequently brought claim against the janitorial service for his injuries. The CGL insurer for the janitorial service denied all liability for the claim, citing the products/completed operations exclusion endorsement (CG 21 44) attached to the policy.

The classification on the CGL declarations for the Janitorial Service was listed as follows:

**96816 Janitorial Services** (Products-Completed Operations Subject to the General Aggregate Limit)

As this claim arose out of operations for which the classification stated products/completed operations were subject to the general aggregate limit, the insurer's claim denial was improper. The claim was *not* included within the products/completed operations hazard and therefore the exclusion for products/completed operations hazard did not eliminate coverage. Thus, the insurer is obligated to defend and pay damages that are the legal obligations of the janitorial service.

**Additional Insured's Sole Negligence**

Most policyholders will, at some point, be required to add unrelated persons or organizations to their CGL policies as additional insureds. The extent of coverage required to be provided is often vague at best, usually buried in a contract that seems to be written in Old English. Nonetheless, the insurer will usually attach one of over 35 ISO additional insured endorsements to the policyholder's CGL policy.

Among the many questions that arise (and often find their way into litigation) is the extent of coverage actually provided to the *additional insured* by the attached endorsement. In particular, it is often represented that the additional insured is being provided coverage only for liability arising out of *activities of the named insured.*

**Sole Negligence.** While this may have been the original concept behind adding an additional insured to the policy, such restrictions are no longer followed by the majority of courts. Additional insureds do have coverage for their sole negligence under most of the ISO additional insured endorsements—as long as their activities arise out of operations performed for the named insured. Of course, other restrictions found in the additional insured endorsement would also apply (e.g., a few have exclusions for negligence of the additional insured).

A Texas Court of Appeals case, *Admiral Insurance Co. v Trident NGL, Inc.*, 988 SW2d 451, 454 (1999) summarized:

The majority view of these cases is that for liability to "arise out of operations" of a named insured it is not necessary for the named insured's acts to have "caused" the accident; rather, it is sufficient that the named insured's employee was injured while present at the scene in connection with performing the named insured's business, even if the cause of injury was the negligence of the additional insured.

The concept of coverage for the sole negligence of an additional insured is further illustrated in a recent (November 2002) Court of Appeals case for Montgomery, Ohio, *Danis Building Construction v Employers Fire Insurance Company*. In this case, the appeals court overruled the trial court's decision that an Ohio anti-indemnification statute restricted the additional insured endorsement to provide liability coverage to Danis (the additional insured) *only* for the vicarious liability of the Mitre Masonry (the named insured). The Ohio Appeals Court stated:

No provision in either policy limits coverage [for the additional insured] to the vicarious liability for the acts of Mitre [the named insured].

In quoting from a New York Court of Appeals case, the *Danis* court further stated:

A distinction must be drawn between contractual provisions which seek to exempt a party from liability to persons who have been injured or whose property has been damaged and contractual provisions, such as those involved in this suit, which in effect simply require one of the parties to the contract to provide insurance for all the parties.

It is interesting to note that ISO has recently proposed additional insured endorsement revisions that apparently will eliminate coverage for the sole negligence of an additional insured. So far, the proposed changes have met with mixed reviews.

**Conclusion**

These are just some of many situations that commonly occur in interpreting the CGL policy. There are likely many more, maybe even with greater and more widespread misunderstanding. It is hoped that this discussion of these situations helps shed some light on the "flood of darkness" that sometimes surrounds the CGL insurance policy.

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