

# The Defense Line

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## The Commercial General Liability Policy Made Simple

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### I. INTRODUCTION

The "Commercial General Liability" ("CGL") policy offered by the Insurance Services Office ("ISO") forms the backbone of liability protection for business owners. It promises to defend and indemnify business owners from liability for bodily injury and property damage to third parties.

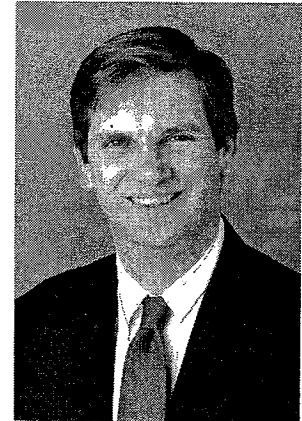
### II. INSURING AGREEMENT AND DEFINITIONS

The CGL, like most liability policies, starts with a broad grant of coverage in the insuring agreement and restricts coverage with exclusions. The insuring agreement focuses the coverage on accidentally caused bodily injury and property damage that occurs during the policy period. It also contains the duty to defend and the duty to indemnify. The duty to defend is a separate duty from the duty to indemnify and is sometimes more valuable than the duty to indemnify.

#### A. Coverage For Accidental and Unintended Injury

The CGL policy responds when there has been "bodily injury" or "property damage" as a result of an "occurrence." Both the definitions of "occurrence" and the intentional injury exclusion, found at exclusion "a" in the ISO CGL policy, operate to limit coverage to fortuitous events. The policy defines "occurrence" as including two types of accidents: sudden accidents and "continuous or

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- ◆ *How to Read an Insurance Contract,*
- ◆ *The Comprehensive/Commercial General Liability Policy in Maryland: A User's Guide,*
- ◆ *The ABCs of CGL Exclusions,*
- ◆ *How to Settle Maritime Claims,*
- ◆ *Effective Reservation of Rights Letters,*
- ◆ *Permissive Use: Beyond Consent,*
- ◆ *Maritime Personal Injury,*
- ◆ *Boat Bailments,*
- ◆ *Your Duty to Provide Security, and*
- ◆ *Cop Chase: The Liability of Police Officers and the State for Injury to Innocent Motorists and Pedestrians.*

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repeated exposure to substantially the same general harmful conditions" accidents. Both types of accidents must occur without the insured's conscious premeditation. Preventive measures taken by the insured to prevent even imminent property damage or bodily injury as a result of a threatened accident do not constitute an occurrence. *W.M. Schlosser v. INA*, 325 Md. 301, 306-09, 600 A.2d 836, 838-40 (1992).

The intentional injury exclusion reinforces this limitation. The exclusion denies coverage for bodily injury and property damage that is "expected or intended from the standpoint of the insured." The accidental nature of the event is judged from the "standpoint of the insured." This is a subjective test that requires more than that the resultant injury be foreseeable. Since foreseeability is an element of negligence, this would defeat the main purpose of the policy. *Sheets v. Brethren Mutual*, 679 A.2d 540 (1996). Instead, the resultant injury or damage must be substantially certain to result from the insured's conduct. Hence, where an insured sexually assaulted a minor, the court inferred intent and rejected the insured's attempt to avoid the exclusion by claiming he did not subjectively intend harm. *Harpy v. Nationwide Mut. Fire Ins.*, 76 Md. App. 474, 483-87, 545 A.2d 718, 722-25 (1988).

Self-defense and insanity may be exceptions to the intentional injury exclusion. The exclusion specifically excepts "bodily injury" resulting from the use of reasonable force to protect persons or property. See, e.g., *Cochran v. Aetna*, 99 Md. App. 305 (1994). "Mental derangement" may negate intent to injure in two situations. First, intent will be voided where the insanity is in a delusional form in which the actor simply does not even "understand the physical consequences of an act." *Erie Ins. Exchange v. Stark*, 962 F.2d 349, 356 (4th Cir. 1992), citing *Reinking v. Philadelphia American Life Ins. Co.*, 910 F.2d 1210, 1215 (4th Cir. 1990). Intent also is negated where the insured suffers an "insane impulse" "in which the actor is unable to resist doing the act in issue, i.e., lacks volitional capacity." *Id.*

### B. Definition Of Bodily Injury

The CGL is triggered only where someone has sustained bodily injury or property damage. Whether the plaintiff has sustained a "bodily injury" is readily apparent in most cases. A burn or a scar is visible to the eye. A strained back or a fractured vertebrae may be diagnosed by a physician. Some injuries, however, are not so clearly "bodily injuries." Pain, suffering, and mental anguish unaccompanied by physical injury is a "bodily injury" under the CGL, *Loewenthal v. Security Ins. Co. of Hartford*, 50 Md. App. 112, 123, 436 A.2d 493, 499 (1982), but may not be under other policy definitions, see, e.g., *Calvin E. Reames v. State Farm Fire and Casualty*, CSA 1650, September Term, 1995, October 1, 1996.

### C. Definition Of Property Damage

The policy contains a two pronged definition of "property damage" that requires either: (1) "[p]hysical injury to . . . tangible property;" or (2) "loss of use." Hence, loss of use alone, without physical injury, may constitute "property damage." Compare *Sheets v. Brethren Mutual*, 679 A.2d 540 (1996).

### D. Trigger Of Coverage

The "trigger" of coverage refers to the event or events that "must happen during the policy period in order for the policy to apply to the claim." *FC&S Bulletins, Public Liability Aat-1* (1986).

The CGL policy limits coverage to "property damage" or "bodily injury" that takes place during the policy period. The negligent act that causes the injury or damage need not take place during the policy period. In most cases, for example an automobile accident or a fire, the "occurrence" and the harm happen simultaneously. This makes the application of the policy simple. In some situations, such as diseases caused by the inhalation of asbestos fibers, the negligent act occurs in one policy period, and the injury may occur later, in a second policy period. Which policy must respond? Maryland appears to have adopted a version of the "injury-in-fact" rule. *Chantel Assoc. v. Mount Vernon*, 338 Md. 131, 656 A.2d 779 (1995); *Harford County v. Hartford Mutual Insurance Co.*, 327 Md.

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*The insuring agreement focuses the coverage on accidentally caused bodily injury and property damage...*

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418, 610 A.2d 286 (1992); *Mitchell v. Maryland Casualty*, 324 Md. 44, 595 A.2d 469 (1991). It provides that the insurer that bears the risk when the injury "in fact" occurs is solely liable. Under the injury-in-fact rule, a CGL policy will be triggered if the injury or damage is determined to have occurred within the policy period irrespective of when the claimant was initially exposed or when the injury eventually manifests itself. While it may be convenient to refer to an "injury-in-fact" test, it is important to remember that this is just a label for the test actually described by the appellate decisions.

### E. Who Is An Insured?

In addition to those named on the declarations page of the policy as insureds, several others are afforded "insured" status. Those who are close to the named insured, such as spouses, directors, officers, and real estate managers are automatically insureds so long as they are acting within the scope of their office. Employees are insureds where they are acting within the scope of their employment, except for actions brought by a fellow employee. Further, others may be added as additional named insureds by endorsement.

### F. Number Of Occurrences

The number of occurrences may effect the amount of coverage available or the number of deductibles. The vast majority of courts apply the "cause" test. A minority apply the "effects" test. The "cause" analysis focuses on the underlying circumstances or the cause of the accident or occurrence. If there is "but one proximate, uninterrupted, and continuing cause, which resulted in all the injuries and damage," then there is one occurrence. The "effects" approach focuses on the effect of the occurrence or accident. This year, Maryland adopted the cause test in *CSX Transportation, Inc. v. Continental Insurance Co.*, 343 Md. 216, 680 A.2d 1082, 1096-98 (1996).

## III. EXCLUSIONS

### A. In General

Most liability policies start with a broad grant of coverage and then limit that grant with exclusions. Exclusions generally fit into one of four categories. First, exclusions allow insurers to avoid duplication of coverage. For example, homeowners and CGL policies exclude risks covered by automobile insurance. Second, exclusions may identify risks for which some, but not all, insureds need coverage so that risk may be separately purchased, e.g., a pollution endorsement or product recall coverage. Third, insurers adopt exclusions to eliminate business risks. Business risks are those risks that are inherent in the insured's business that are within the control of the

insured; i.e., the quality of the product or service. Fourth, exclusions hedge against risks that the insurer cannot measure or that are too great to undertake. For example, no one wants to insure a home built next to a dynamite factory. The "intentional injury" exclusion was addressed above. Several other significant CGL exclusions are addressed in this section.

### B. Contractual Liability Exclusion

The Contractual Liability exclusion, exclusion "b" in the ISO CGL policy, is designed to eliminate contractual liability with two exceptions: (1) "insured contracts" and (2) liability the insured would have absent an assumption of liability. "Insured contracts" include all business agreements to assume the *tort liability* of another. Therefore, most indemnity agreements the insured enters into in the normal course of business are not excluded. It is important to distinguish between the insured's liability for assuming the liability of another and the insured's liability for breach of contract. CGL Insurance does not cover the liabilities of the insured for breach of contract; it accepts the risk for the insured's tort liability only.

The second exception to the Contractual Liability exclusion is triggered when the insured would have been liable for damages even in the absence of the contract. For instance, there is coverage when the insured's liability is based on negligence. Liability in this scenario is *not* based on the contract; therefore, the insurer accepted the risk of coverage.

### C. Pollution Coverage And The Pollution Exclusion

The absolute pollution exclusion, exclusion "f" in the ISO CGL policy, contains two parts. The first part concerns "bodily injury" or "property damage" arising out of specified polluting events. This section contains an exception for injury or damage "arising out of heat, smoke or fumes from a hostile fire." A "hostile fire" means one that becomes uncontrollable or breaks out from where it is supposed to be. The second part excludes "[a]ny loss, cost or expense arising out of any governmental direction or request." Maryland has applied the exclusion to indoor personal injury cases. *Bernhardt v. Hartford Fire Ins.*, 102 Md. App. 45, 648 A.2d 1047 (1994). It has not applied it to lead-based paint poisoning cases. *Allstate Ins. Co. v Sullins*, 340 Md. 503, 667 A.2d 617 (1995).

### D. Workers' Compensation Exclusion

Workers' compensation, disability benefits and unemployment compensation are excluded because specifically designed policies are available to cover those risks.

### E. Employer's Liability Exclusion

The ISO CGL policy excludes coverage for claims arising out of injuries to employees of the insured, where they arise out of and in the course of the employment. This includes any claim brought by the spouse, child, parent, brother or sister, of the employee. Further, it bars coverage for any claim

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brought by an employee under the "dual capacity" doctrine. See generally, *Hurt v. Pennsylvania Threshermen & Farmers' Mutual Cas. Ins. Co.*, 175 Md. 403, 2 A.2d 402 (1938). This is the subject of Employer's Liability endorsements.

#### **F. Care, Custody, and Control, Property Owned, And Alienated Property Exclusions**

Exclusion "j" in the ISO CGL policy combines the owned property exclusion, the care, custody and control exclusion, and the alienated premises exclusion. Liability insurance is only intended to cover liability to third persons. The owned property and care, custody and control exclusions are designed to avoid coverage on property that should be covered under property insurance. These exclusions eliminate coverage in situations in which the insured is closely connected with the damaged property by the exercise of some sort of control over it. See, e.g., *Reynolds v. Select Properties, Ltd.*, 616 S.2d 742 (1993) and *Arnold v. Adventure Line Mfg. Co.*, 209 Kan. 80, 495 P.2d 1007 (1972). The alienated premises exclusion is designed to eliminate coverage where the insured fails to repair property or disclose the existence of a defect in the premises prior to a sale.

#### **G. Impaired Property Exclusion**

The "impaired property" exclusion, exclusion "m" in the ISO CGL policy, is aimed at eliminating coverage for several workmanship issues where there has been no physical injury. The first part of the exclusion addresses situations where the insured's product is a component of a larger product. If the larger product is defective and hence less useful or unusable, and it can be repaired or restored by replacing the insured's product, then the exclusion applies. The second part of the exclusion applies to loss of use of other property due to a delay by the insured in performing a contract. Failure to deliver construction supplies may result in the delay in construction of a building, but the losses are excluded. See, e.g. *Woodfin v. Harford Mutual*, 110 Md. App 616 (1996). Since the insured has control over these workmanship issues, the insurer should not bear the risk of liability, and coverage is properly excluded.

The "impaired property" exclusion has an exception for "loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use." For example, if the insured installed a boiler in a building that explodes, making the building unusable, the exclusion does not apply.

#### **H. Damage To Products And Work Performed Exclusions**

Exclusion "k" in the ISO CGL policy, the Damage to Products Exclusion, provides that if the insured's product suffers damage, he may not look to recover from his own CGL insurer. Exclusion "l" in the ISO CGL policy, the work performed exclusion, has the same purpose but applies to services rather than products. Both of these exclusions exclude any guarantee as to the quality and fitness of any product sold

by the insured, or the initial cost of the work performed by the insured and the cost of doing it over. However, if the insured's faulty work results in property damage to others, the resultant damage is covered. See *Woodfin v. Harford Mutual*, 110 Md. App 616 (1996).

#### **I. Product Recall Or Sistership Exclusion**

The Product Recall or Sistership exclusion, "exclusion "n" in the ISO CGL policy, is intended to apply to the expenses of withdrawal, etc., for all similar or "sister" products or work, and the resulting loss of use. Damages to others due to the failure of the product or work are not excluded. Further, the sistership exclusion is not intended to apply to a product that has failed, "but only to a sister product withdrawn after failure of the first product." *American Home Assurance v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 29 (1st Cir. 1986).

### **III. CONDITIONS**

#### **A. Notice And Cooperation**

The CGL requires the insured to notify the insurer in the event of an "occurrence, claim or suit" and to cooperate in defending any claims or suits. However, an insurer's ability to disclaim for late notice or failure to cooperate is limited by *Ann. Code of Md.* Article 48A § 432, which requires proof of "actual prejudice" before it can disclaim either its duty to defend or its duty to indemnify. Whether the insurer has suffered "actual prejudice" is a question of fact rather than law. There is no bright line test, but the insurer has the heavy burden of proving that the insured's omission(s) prejudiced the insurer's investigation or defense of the case. See, e.g., *Hartford Accident v. Sherwood*, 111 Md.App. 94 (1996) and *Woodfin v Harford Mutual*, 110 Md. App. 616 (1996).

This statutory requirement does not usually apply to claims-made and reported policies. *T.H.E. Insurance Co. v. P.T.P. Inc.*, 331 Md. 406, 628 A.2d 223 (1993) (the statute does not apply to a claim made against the insured after the policy had expired).

#### **B. Separation Of Insureds**

The "separation of insureds" provision clarifies that the coverage analysis must be done separately for each insured. Although all the insureds draw on a common limit of liability, it is as though a separate policy had been issued for each insured.

### **IV. CONCLUSION**

The Commercial General Liability policy provides remarkably flexible protection for business owners. It protects the insured against most, but not all, of the tort liability it is likely to encounter. ■