PRODUCTS LIABILITY CONSUMER CLASS ACTION CLAIMS: WHEN ARE THEY COVERED BY INSURANCE?

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Consumer class action claims are a familiar tool for addressing dissatisfaction with a defective product. Given that one of the goals of a consumer class action claim is to recover damages for the claimants, triggering insurance coverage for the defendant can be critical to a successful result. Likewise, defendants are eager to have an insurance company fund their defense, contribute to settlements, or pay judgments. From the insurer's perspective, due to the high potential for damages, insurance companies take an aggressive stand to avoid coverage.

The tension between the plaintiffs' goal of certifying a class versus triggering the elements of insurance coverage is clearly evident. On the one hand, certification requires common facts and injuries among the class members. Once individual damages are alleged, it becomes more difficult to overcome objections to class certification.[1]

1. *See* Low v. Golden Eagle Ins. Co., 120 Cal. Rptr. 2d 827 (2002) (no duty to defend where "the . . . complaint is . . . couched overwhelmingly in class action terms, but the named plaintiff expressly disclaims any interest in seeking recovery of damages for [the type of damages] . . . required to trigger coverage and a related duty to defend under the policy"); *see also* Upper Deck Co. v. Fed. Ins. Co., 358 F.3d 608, 616 (9th Cir. 2004) ("Upper Deck asked us to remember that the underlying suit is a class action and that, even if the

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On the other hand, insurance was triggered before the class was certified in *Hartford Accident and Indemnity Co. v. Beaver*.[2] Hartford's insured operated numerous nursing home facilities and was sued in a class action by residents for failure to provide adequate care and services. Hartford argued, and the district court agreed, that there was no duty to defend until such time as the class was certified. On appeal, the Eleventh Circuit reversed, finding that the duty to defend "was not defeated by some uncertainty as to the merits of a class certification."[3] It held that there were sufficient "allegations of personal injury against putative class members to trigger the duty to defend," notwithstanding that the class had not been certified.[4]

The underlying plaintiffs' status as a class should not impact the analysis of whether the policy covers the claims in the underlying action.[5] The court in *Omega Flex, Inc. v. Pacific Employers Insurance Co.* specifically stated, "[W]e do not believe that an insured must demonstrate that the plaintiffs will satisfy Rule 23 in order to receive a defense from its insurer. Just as in any other type of action, the insurer's duty to defend is determined by looking to the face of the complaint."[6] It specifically interpreted that rule to mean that,

> [i]n the context of a class action complaint, we understand that principle to mean that we should avoid anticipating the possible outcome of the certification process . . . [because] [t]he fact that some of the claims may ultimately be deemed unsuitable for class treatment should not deprive the insured of the benefit of a defense, provided the complaint fairly can be read to assert one or more claims that fall within the scope of the policy.[7]

Given these strong conflicting interests, the courts have issued a multitude of decisions with varying results. Similar to the developed body of law relating to coverage in defective construction cases, consumer products class actions have triggered disputes regarding: whether the complaint's allegations meet the definition of an occurrence, property damage, or bodily injury; when did the damage or injury occur; is anything more than economic loss or injury alleged; is advertising injury or product

named plaintiffs did not suffer bodily injury, members of the class could have suffered bodily injury. This argument contradicts the complaint itself, which states [that the named class plaintiffs are typical of the class as a whole.]").

2. 466 F.3d 1289 (11th Cir. 2006)

3. *Id.* at 1295.

4. *See* Lenscrafters, Inc. v. Liberty Mut. Fire Ins. Co., 2005 WL 146896 (N.D. Cal. 2005).

5. 937 N.E.2d 52, 57–58 (Mass. Ct. App. 2010).

6. *Id.* at 58.

7. *Id.*; *see also* Hartford Accident & Indem. Co. v. Beaver, 466 F.3d 1289, 1293 (11th Cir. 2006) ("Nothing in Florida law even remotely suggests that the potential for coverage created by a class action is qualitatively different from the potential for coverage created by an individual action. Florida's courts have uniformly said that a suit alleging facts that fairly and potentially bring the suit within policy coverage triggers an insurer's duty to defend.").

disparagement, loss, or injury alleged; and which product exclusions apply. This article will focus on the elements necessary to trigger coverage and the arguments made to deny coverage.

I. GENERAL PRINCIPLES REGARDING PLEADING

Courts have not created any bright-line test as to what facts must be alleged to trigger coverage. One must consider not only factual allegations, but the entire complaint, including the damages suffered and the requested relief, to determine whether any potentially provable loss falls within the policy's coverage. However, jurisdictions have ruled differently regarding whether courts should speculate on the facts necessary to support potential coverage. The Seventh Circuit held in *Amerisure Mutual Insurance Co. v. Microplastics, Inc.*[8] that "the duty to defend applies only to facts that are *explicitly alleged*" because "it is the actual complaint, not some hypothetical version, that must be considered."[9] Thus, the potentiality standard must be balanced against speculative theories of liability and hypothetical damages.

The courts have reached conflicting decisions regarding whether the pleadings contained in allegations are sufficient to trigger coverage based upon the prayer for relief in the complaint. In *HPF, L.L.C. v. General Star Indemnity Co.*, the Illinois Appellate Court reversed the lower court ruling that General Star breached its duty to defend its insured, HPF, holding that the complaint in the underlying action failed to allege facts falling within (or potentially within) coverage because

> the core of [the underlying] claim is that HPF misled the public that its Herbal Phen–Fen products were proven safe and effective for the treatment of obesity, when in fact, those products were not approved. The [underlying] complaint does not seek damages for any sickness or injury caused by ingesting HPF's herbal products; it seeks injunctive remedies for the misrepresentation of the quality and effectiveness of the products.[10]

It addressed the fact that the plaintiffs in the underlying complaint requested that the court establish a medical monitoring fund, stating that this request did not bring the underlying complaint within or potentially bring within coverage because it was a prayer for relief rather than an allegation of bodily injury.[11] The court declined to presume that the un-

8. 622 F.3d 806, 812 (7th Cir. 2010).

9. For other cases dealing with unclear allegations that may trigger the duty to defend, *see* also Alan Van Etten, *Triggering the Duty to Defend for Inartful Pleadings*, CGL REPORTER, Fall 2012, www.irmi.com/online/cgl/sc000050/triggering-the-duty-to-defend-for-inartful-pleadings.aspx.

10. 788 N.E.2d 753, 757–58 (Ill. Ct. App. 2003).

11. *Id.* at 758.

derlying complaint therefore alleged that the products caused bodily injury.[12]

In *Omega Flex*, however, the Massachusetts Court of Appeals specifically stated that courts should "look at the entire complaint, *including the prayer for relief*, in order to determine whether the allegations are reasonably susceptible of stating a claim that would fall within the zone of covered injuries."[13] The insured manufactured and sold corrugated stainless steel tubing that was installed in floors, walls, and attics of residential, commercial, and industrial properties to transmit gas to gas-fueled appliances.[14] The plaintiffs in the underlying action alleged that "CSST was designed, manufactured, marketed, sold, distributed, and/or placed into the stream of commerce without sufficient thickness to protect against combustion after a lightning strike" and sought damages to provide protection from the alleged defect, as well as to provide notice to class members whose properties already had been damaged so that they could seek additional payment for their loss.[15] The prayer for relief specifically requested

> c) . . . award an amount equal to the cost to install lightning strike protection and insulation to stop lightning strikes from contacting the premises and/or install appropriate grounding of the pipes, thereby preventing the CSST piping from causing fires . . . ;
>
> d) Awarding such equitable relief permitted, including an injunction requiring Defendants to notify all Class Members that they are entitled to submit an additional or supplemental request for payment in connection with their prior loss and/or damage to their structure and/or premises. . . .[16]

The *Omega Flex* court recognized that injunctive relief by itself does not constitute "damages" within the scope of coverage, but clarified that "injunctive relief that requires the insured to incur costs to remedy covered losses is 'damages' within the scope of the policy."[17]

The U.S. District Court for the Northern District of California recently held that the allegations in a complaint could put an insurer "on notice of the potential for coverage under the terms of the policy."[18] The underlying action alleged that the insured's Bluetooth Headsets can cause noise-induced hearing loss and the packaging lacks adequate warnings.[19] The underlying action sought "damages for economic injury

12. *Id.*
13. 937 N.E.2d 52, 57 (Mass. App. Ct. 2010) (quotation omitted) (emphasis added).
14. *Id.* at 55.
15. *Id.*
16. *Id.*
17. *Id.* at 57.
18. Plantronics, Inc. v. Am. Home Assurance Co., 2014 WL 2452577, at *4 (N.D. Cal. May 30, 2014).
19. *Id.* at *1.

and [did] not seek damages for any physical injury that may have been sustained by Class members."[20] The court found that "the underlying actions in this case go to great length to describe the noise-induced hearing loss risk engendered through extensive use . . . [and] [b]ecause allegations in the underlying actions traced covered claims that could be added through amendment, the underling complaint's amendment to seek damages because of bodily injury was not speculative."[21] The court found that, because such amendments were not speculative and the insurer had notice that the allegations supported such claims, the insurer had a duty to defend the insured.

II. IS THERE AN OCCURRENCE?

A. *Expected or Intended Injury*

In order for coverage to apply, bodily injury or property damage must be caused by an occurrence, defined as an "accident." Insurers argue that intentional conduct is generally not an occurrence while claimants and policyholders focus on whether the resulting injury was expected or intended.

By definition, there is no occurrence where "bodily injury" or "property damage" is expected or intended from the standpoint of the insured. Whether there is an occurrence is a common threshold question in consumer class action product liability suits. In *Liberty Mutual Insurance Co. v. Pella Corp.*,[22] two underlying class action lawsuits were filed against Pella Corporation and Pella Windows and Doors, Inc. (collectively, Pella), a window manufacturer, alleging that Pella's windows were defective. Pella tendered both class actions to its insurers. The court in *Liberty Mutual Insurance Co. v. Pella Corp.* determined whether the policy covered the underlying class action litigation in which the complaint alleged that the insured "sold its windows with the knowledge of both the existence of the alleged defect, and that there was a *possibility* that the defect would result in damage."[23] The court concluded that, because the underlying actions did not "clearly and unambiguously allege" that the insured "expected" the defect to cause damage, a scenario that would not be covered under the policy, there was still a potential that the insured could be found liable for damage caused by an "occurrence."[24]

In *Compaq Computer Corp. v. St. Paul Fire & Marine Insurance Co.*, the underlying class action complaints alleged that Compaq intentionally sold

20. *Id.*
21. *Id.*
22. 631 F. Supp. 2d 1125 (S.D. Iowa 2009), *aff'd in part, rev'd in part*, 650 F.3d 161 (8th Cir. 2011).
23. *Id.* at 1133 (emphasis in original).
24. *Id.* at 1133–34.

computers that contained defective floppy-diskette controllers and floppy-diskette controller microcodes, which caused the loss of use, corruption, and destruction of data.[25]

While the relevant insurance policy was a Technology Errors and Omissions, rather than a CGL, policy, it contained an exclusion for damage that the insured "expected or intended." The policy covered certain errors ("any error, omission, or negligent act") or events ("an 'accident,' including continuous or repeated exposure to substantially the same general harmful conditions).[26] The policies did *not* cover criminal, dishonest, fraudulent, or intentionally wrongful acts, or damage that the insured "expected or intended."[27] St. Paul denied coverage, citing the following facts in the underlying complaints:

> (1) the amended complaints alleged damages arising entirely from "intentional" conduct, which did not constitute an "error" under the Tech E & O policy; (2) the amended complaints sought to hold Compaq liable under the Computer Fraud and Abuse Act, 18 U.S.C. § 1030, a criminal statute that requires "knowing" and "intentional" conduct; (3) the injunctive, declaratory, and other equitable relief sought by the plaintiffs did not constitute "damages" that Compaq was legally required to pay; and (4) the amended complaints sought a refund of the purchase price, repair or replacement of the defective computer or component parts, and attorney fees and costs, none of which were covered "damages" as defined by the policy.[28]

The court agreed, determining that, because the underlying complaints alleged intentional and knowing conduct by the insured, the insurer had no duty to defend because the intentional-acts exclusion of the policy clearly barred coverage.

In *Indalex v. National Union Fire Insurance Co.*,[29] the Pennsylvania Supreme Court refused to review the lower court ruling in which the court found the door and window manufacturer insured was entitled to insurance coverage for a series of lawsuits claiming that defective windows and doors caused water leaks, mold, cracked walls, and injuries. The reviewing appellate court panel found that the claims could be considered occurrences because the definition was based on the insured's subjective viewpoint and the damages such as mold–related health issues were arguably not expected.

25. Compaq Computer Corp. v. St. Paul Fire & Marine Ins. Co., 2003 WL 22039551, at *1 (Minn. Ct. App. Sept. 2, 2003).
26. *Id.*
27. *Id.*
28. *Id.* at *2.
29. 99 A.3d 926 (Pa. 2014), *denying review*, 83 A.3d 418 (Pa. Super. Ct. 2013).

B. *Whether the Underlying Action Presents a Single Occurrence or Multiple Occurrences Under the Policy*

Another question facing insurers when assessing coverage of claims is whether each claim constitutes a separate occurrence or is part of a single occurrence. This issue arose in *Sunoco, Inc. v. Illinois National Insurance Co.*, where the insured was self-insured up to $250,000 per occurrence and an aggregate of $5 million.[30] The insured was a defendant in numerous lawsuits asserting claims based on its manufacture and distribution of gasoline containing methyl tertiary-butyl ether (MtBE), an additive that was originally thought to reduce the amount of carbon released into the air during the burning of gasoline.[31] Because the insured had not spent more than $250,000 on each claim in the underlying lawsuits, the claims would need to be deemed to arise from a single occurrence to invoke the insurer's duty to defend.[32] The court concluded that, although the claims underlying the lawsuits were not identical, each claim alleged the same cause of action and therefore arose from a single occurrence.[33]

III. HAS THERE BEEN PROPERTY DAMAGE AS REQUIRED BY THE POLICY?

Starting with the most basic elements of the insuring agreement in a CGL policy, an insured products liability case must allege an occurrence that results in property damage or bodily injury.[34] Property damage is defined in CGL policies as "physical injury to tangible property" or "loss of use of tangible property that is not physically injured."

If coverage is sought for property damage claims under a CGL policy, the policy requires actual physical injury to property or persons. In *Amtrol, Inc. v. Tudor Insurance Co.*, a class action suit alleging that insured's leaking water heaters were "defective" and "dangerous" products that caused property damage and posed a risk of bodily injury, the court found that the insured was not entitled to summary judgment because "in order to meet the physical damage requirement, one must show that the water has somehow exacted a physical harm upon tangible property that required remediation or otherwise diminished the value of the property itself . . . [and a] leak that results in no damage beyond the mere presence of water that can be removed or evaporates without harm does not constitute property damage."[35] The court denied the in-

30. 226 F. App'x 104, 107 (3d Cir. 2007).
31. *Id.* at 105.
32. *Id.* at 107.
33. *Id.* at 108.
34. Personal and advertising injury liability is addressed in Part VI.
35. 2002 WL 31194863, at *6 (D. Mass. Sept. 10, 2002).

sured's motion on that theory because the insured did not produce any evidence of actual water *damage* caused by water leakage.[36] The court also concluded that the insured's request for mitigation costs was not covered under the policy for two reasons: the costs incurred by the insured were attributable to the insured's warranty program "and not directly because of an interest in mitigating property damage or reducing their liability," and

> [t]he vast majority of the damages incurred by Amtrol were for repair and replacement costs, a form of first party liability that CGL policies are not designed to cover. . . . While reimbursement for such first party liability may be acceptable when the product causes actual third party damage, it stretches the analogy too far to allow coverage based on the prevention of potential property damage.[37]

The "possibility" standard for triggering a duty to defend plays a considerable role here because potential property damage may be alleged by references to individual class members' experiences. For example, in *Omega Flex*,[38] which involved a consumer class action alleging that defective stainless steel tubing was prone to combusting when lightning struck nearby, the lower court held that the insured's CGL carrier had no duty to defend because the complaint contained no specific allegation of fire damage. The appellate court reversed, citing potential recovery for fire damage to some class members' property as a result of the product combusting. The court based the reversal on the amended complaint, which sought relief for some class members who had already suffered actual damage to their premises. It was not necessary for the complaint to allege that specific damages had been suffered, as long as it was within the realm of possibility that even one class member incurred property damage, to trigger the duty to defend.

In *Hartford Fire Insurance Co. v. Thermos L.L.C.*, the court considered arguments on the insurers' declaratory judgment actions seeking a declaration that they had no duty to defend the insured in the underlying class action litigation.[39] The underlying litigation was based on claims by consumers that they paid premium prices for bottles manufactured by Thermos and advertised as "leak-proof," when the bottles, in fact, had a tendency to leak from the straw and the gap between the lid and straw.[40] The court determined that it was not clear on the face of the underlying complaint that there were no allegations of property damage to

36. *Id.*
37. *Id.* at *8.
38. 937 N.E.2d 52, 65–66 (2010).
39. 2015 WL 7293509, at *1 (N.D. Ill. Nov. 19, 2015).
40. *Id.*

property other than the bottles themselves because the underlying complaint did include allegations that the leaking bottles would soak the contents of diaper bags (physical injury to tangible property) with spilled milk and juice (loss of use of tangible property).[41] The court also concluded that the underlying complaint did allege an occurrence under the policies because "the alleged loss of use of milk, juice, or other liquid, or damage to the contents of a diaper bag in which the defective bottle is placed is sufficient to constitute an 'occurrence,' as this damage occurs not to the product itself but to other property."[42] The court also held that the "expected or intended injury" and various business risk exclusions did not preclude coverage.[43] The court ultimately refrained from ruling on the duty to defend and estoppel issues, however, because the insurers explicitly reserved the right to rely on additional exclusions not addressed in the motions before the court.[44]

A. *Must Allege Damage to Tangible Property*

In cases in which the underlying complaint involves claims of property damage, the courts look to the nature of the damage and the allegedly damaged property to determine whether coverage exists. In *America Online, Inc. v. St. Paul Mercury Insurance Co.*,[45] the Fourth Circuit used a somewhat philosophical discussion about the nature of tangible property in the aftermath of a series of consumer class actions against AOL following release of its Version 5.0 Access software, which alleged that the software had significant "bugs;" was incompatible with their computers' other applications, software, and operating systems; and damaged the computers.

The plaintiffs in the underlying suit alleged that AOL 5.0 was a defective product and that the defect in the product caused physical damage to customers' tangible property, which the complaint defined as taking "the form of computers, computer data, software and systems." The court first held that "computer data, software and systems are not 'tangible' property in the common sense understanding of the word" because, contrary to the plain and ordinary meaning of "tangible" property ("property that can be touched"), "[c]omputer data, software and systems are incapable of perception by any of the senses and are therefore intangible."[46] The court then found that St. Paul had no duty to defend AOL against allegations of damage to the underlying plaintiffs' computer data, software, and systems because such damage was not covered under the policy. The court

41. *Id.* at *5–9.
42. *Id.*at *9.
43. *Id.* at *10.
44. *Id.* at *11.
45. 207 F. Supp. 2d 459, 461 (E.D. Va. 2002), *aff'd*, 347 F.3d 89 (4th Cir. 2003).
46. *Id.* at 462.

went on to state that St. Paul generally *would* have a duty to defend AOL against claims of damage to the computers themselves "because [they are] obviously tactile, corporeal item[s]" and therefore could potentially be covered by the insurance policy.[47] But the court clarified that, due to the nature of the damage to the computers (loss of use versus physical damage to the objects themselves), the impaired property exclusion applied.[48] Under the policy, "impaired property" was defined as "tangible property, other than [AOL's] products or completed work, that can be restored to use by nothing more than: [1] an adjustment, repair, replacement, or removal of [AOL's] products or completed work which forms a part of it; or [2] [AOL] fulfilling the terms of a contract or agreement."[49] The exclusion barred coverage for any "property damage to impaired property, or to property which isn't physically damaged, that results from: [1] [AOL's] faulty or dangerous products or completed work; or [2] a delay or failure in fulfilling the terms of a contract or agreement."[50] The court concluded, therefore, that St. Paul had no duty to defend AOL against the underlying claims of damage to either the computers themselves (the impaired property) or the computer data, software, or systems (the intangible property).[51]

On appeal, the court held that the word "tangible" is unambiguous and simply means (according to Webster's *Third New International Dictionary*) "having physical substance apparent to the senses." Employing what the court characterized as "these ordinary meanings," it concluded that the physical magnetic material on the hard drive that retained data, information, and instructions is tangible property. However, it noted that the conclusion that physical magnetic material on the hard drive is tangible property is separate from the question of whether the data, information, and instructions, which are codified in a binary language for storage on the hard drive, are tangible property.

In essence, the court distinguished between the hard drive as a medium in which data, information, and instructions are stored and the data itself. The court concluded that, with this distinction in mind, loss of software or damage to software is not damage to the hardware, but to the idea, its logic, and its consistency with other ideas and logic. The court analogized to a situation where a combination to a combination lock is forgotten or changed. The lock becomes useless, but is not physically damaged. With the retrieval or resetting of the combination, i.e., the idea, the lock can be used again.

47. *Id.*
48. *Id.* at 470.
49. *Id.* (alterations in original).
50. *Id.* (alterations in original).
51. *Id.*

In contrast to the *AOL* decision, in *Eyeblaster, Inc. v. Federal Insurance Co.*,[52] the Eighth Circuit found that tangible property damage had occurred where a consumer alleged that (1) his computer was infected with a spyware program from Eyeblaster's website, causing it to immediately freeze up; (2) he lost all data on a tax return on which he was working; and (3) he incurred many thousands of dollars of loss. He hired a computer technician to repair the damage and alleged that no repair was possible. Eyeblaster tendered the defense of the lawsuit to Federal, seeking coverage under its general liability policy.

On appeal, the court, applying Minnesota law, found that the allegations of the complaint were covered. Although Federal did not include a definition of "tangible property" in the GL policy, the plain meaning of tangible property included computers, and the underlying complaint alleged repeatedly the "loss of use" of the plaintiff's computer. Thus, the court held there was both coverage and a duty to defend under the GL policy.

B. *Loss of Use*

Other than focusing on damage to tangible property, the other prong of the definition of property damage focuses on the "loss of use" of property other than the named insured's product. As an example, in a recent class action involving alleged defects in glass bottles, the insured was able to argue that the class members' damages for having to destroy the contents of the bottles constituted property damage. Thus, damage caused by the loss of use of the contents, which were not the insured's product, was covered.

In *Silgan Containers, LLC v. National Union Fire Insurance Co. of Pittsburgh, Pa.*,[53] the Ninth Circuit, in an unpublished order, reversed a district court ruling that granted National Union summary judgment based on its conclusion that there had been no property damage. On remand,[54] the district court denied both parties' motions for summary judgment. Silgan manufactures cans for commercial producers of canned food goods. Del Monte, one of Silgan's customers, discovered an abnormally high number of tomato cans that were experiencing premature failure. Del Monte destroyed its remaining inventory and presented Silgan with a multimillion dollar claim. National Union denied coverage for approximately $4 million. The issue was whether Silgan was entitled to coverage based on a risk of future damage to the cans that were destroyed. The court found that the existence of physical injury to the tomato product

52. 613 F.3d 797 (8th Cir. 2010).

53. 543 F. App'x 635 (9th Cir. 2013), *remanded*, No. C09-5971 RS (N.D. Cal. July 30, 2014).

54. *Silgan Containers, LLC*, No. C09-5971-RS.

in some cans arguably supported an inference, and therefore a triable issue of fact, that similar physical injury existed in the cans that were destroyed. The court noted that the Ninth Circuit explicitly held there was a genuine issue of material fact as to whether Del Monte suffered a "loss of use" of the tomato product. That holding convinced the district court to deny the motions for summary judgment.

C. *Is There Property Damage Before the Defective Product Causes Damage?*

It would be difficult to begin any discussion of what determines whether property damage has occurred without starting with the Seventh Circuit's 1992 decision of *Eljer Manufacturing v. Liberty Mutual Insurance Co.*[55] Eljer brought a declaratory judgment to establish that the physical injury to the buyer of a Qest plumbing system occurs when the system is installed in the buyer's house or apartment, not when it begins to leak, is replaced, or recognized to have reduced the value of the buyer's property. The Seventh Circuit held that the incorporation of a defective product into another product constitutes property damage, as physical injury to tangible property, at the moment of incorporation. The court based its decision on Illinois cases that it read as holding that the absence of physical injury in the ordinary sense was immaterial, as long as the insured's defective product reduced the value of the finished product.

It took almost ten years for the Illinois Supreme Court to consider whether the Seventh Circuit was correct in predicting Illinois law. Not surprisingly, the court disagreed and held that the homeowners whose systems did not leak suffered no "physical injury to tangible property."[56] The court also held that the post-1981 policies were not triggered if a home was physically damaged by a homeowner replacing a nonleaking system; this did not constitute physical injury to tangible property arising from a covered occurrence under the policies.

Many insurers would argue that the policy in place at the time the actual property damage occurs is the only potentially applicable policy. However, be aware of the decision in *Eljer*.[57] In *Eljer*, the plaintiffs in the underlying litigation alleged that the insured's plumbing system leaked, and repairing or replacing the plumbing systems required breaking through floors, ceilings, or walls because they were integrated into the plaintiffs' homes.[58] The policy defined "property damage" as "physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom" or the "loss of use of tangible property which has not been physi-

55. 972 F.2d 805 (7th Cir. 1992).
56. 757 N.E. 2d 481 (Ill. 2001).
57. 972 F.2d 805 (7th Cir. 1992).
58. *Id.* at 807.

cally injured or destroyed provided such loss of use is caused by an occurrence . . . during the policy period."[59] The insurer and insured disagreed about when the injury actually occurred; the insurance policy was in effect at the time of the installation of the plumbing systems, but not at the time of the discovery of the leaks. The court determined that the drafters of the policy intended that an occurrence under the policy is "a loss that results from physical contact, physical linkage, as when a potentially dangerous product is incorporated into another and, because it is incorporated and not merely contained . . . , must be removed, at some cost, in order to prevent the danger from materializing."[60] The court finally concluded that "incorporation of a defective product into another product inflicts physical injury in the relevant sense on the latter at the moment of incorporation" and that, because the policy was in effect at that time, the insurer had a duty to defend the insured.[61]

In *Amtrol Inc. v. Tudor Insurance Co.*,[62] the court faced an "*Eljer*-like" situation, in which Amtrol, a manufacturer of residential water heaters, faced a class action suit seeking costs of defense, as well as the costs of repair and replacement of defective products that experienced leaks. In granting Tudor's motion for summary judgment, the court held that in order to meet the physical damage requirement, Amtrol must show that the water had somehow exacted a physical harm upon tangible property that required remediation or otherwise diminished the value of the property. "A leak that results in no damage beyond the mere presence of water that can be removed or evaporated without harm does not constitute property damage."[63]

The decision in *Wausau Underwriters Insurance Co. v. United Plastics Group, Inc.*[64] is an example of when water leaks can constitute property damage. In that case, United Plastics Group (UPG) sold a plastic chamber component in which water was to be heated to Microtherm, a manufacturer of tankless water heaters. UPG molded the plastic chambers at a significantly lower temperature than recommended by the plastic manufacturer. As a result, the water chambers made and sold to Microtherm were defective and caused many of the water heaters that contained them to fail. Of 3,900 water heaters sold, 600 of the water chambers ruptured. Microtherm filed suit against UPG. At trial, the jury awarded $26.5 million to Microtherm—$1.1 million for the cost of repairing or replacing

59. *Id.*
60. *Id.* at 810.
61. *Id.* at 814.
62. 2002 WL 31194863 (D. Mass. Sept. 10, 2002).
63. *Id.* at *6.
64. 512 F.3d 953 (7th Cir. 2008).

the water heaters, and most of the balance for lost profits resulting from customers' anger.

Wausau Underwriters Insurance Company, UPG's primary liability insurer, brought an action against UPG, seeking a declaration that its policy did not cover the underlying judgment. UPG and Wausau ultimately settled. In the interim, however, Ohio Casualty Insurance, UPG's excess liability insurer, had intervened in the suit against UPG, seeking a similar declaration.

Of the 600 water chambers that ruptured, only sixty-five to seventy-five ruptured while Ohio Casualty's policy was in force. After a bench trial, the trial court ruled that Ohio Casualty was liable for the damages assessed in the underlying action up to the $25 million policy limit.

On appeal, the Seventh Circuit recognized that the test for coverage was whether the damaged property was the property of UPG when the defect on which UPG's liability was based came into being. The Seventh Circuit ruled that there was property damage as a result of the defective manufacture of the water chambers. Circuit boards belonging to Microtherm were damaged, and some of the water heater owners suffered damage to their property due to leaking. Because UPG manufactured only the water chamber, the rest of the heater constituted a third party's property. Once there is damage to such property, the victim can recover its losses, including business losses resulting from that damage and not just the diminution in the value of the property.

The Seventh Circuit also acknowledged that *Viking Construction Management, Inc. v. Liberty Mutual Insurance Co.*[65] precluded UPG from obtaining insurance coverage for the cost to Microtherm of repairing or replacing any of the defective water chambers. The court nonetheless reversed the trial court's decision because less than 2 percent of the 3,900 heaters failed during the Ohio Casualty policy period. The court observed that the business losses resulting from those failures were unlikely to have amounted to $25 million. The court also observed that only 80 percent of the water chamber ruptures shorted the circuit board. The other 20 percent just caused the water heater to stop working, which did not constitute covered property damage.

Although arising in a construction setting, the court in *Kaufman & Broad Monterey Bay v. Travelers Property Casualty Co. of America*[66] addressed the issue of property damage caused by the installation of defective cabinets in certain homes in a housing development. The complaints alleged damage and wearing to the base, door, drawers and finish of the cabinets; gouging of drywall and interior painting; and cracking and se-

65. 831 N.E.2d 1 (Ill. App. Ct. 2005).
66. 2012 WL 2945932 (N.D. Cal. July 18, 2012).

paration of drywall and caulking. The court noted that the complaint did allege damage to the homes and their component parts, for which plaintiffs would incur expenses for the restoration and repair of the property. Thus, the court held that the complaint alleged a claim that potentially could subject the builder to liability for physical injury to property other than the cabinets, covered by the cabinetmaker's general liability policy.

In *Sony Computer Entertainment America, Inc. v. American Home Assurance Co.*,[67] Sony was sued in two class actions in which plaintiffs alleged that PlayStation 2s suffered from defects that rendered them unable to play DVDs and certain game discs. In determining whether there was coverage for the claims under Sony's CGL policies, the court rejected Sony's argument that the suits alleged both "loss of use of tangible property" and "physical injury to property." Although the complaints alleged PlayStation 2 was unable to read or play CDs, DVDs, or other games and that discs skipped and froze, accompanied by banging or clicking noises, the court noted that the plaintiffs did not allege any recognized measure of loss of use of discs, such as rental value.

Coverage for cases in which the named insured's products have been incorporated into another product has received inconsistent treatment. In *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*,[68] the court recognized the existence of coverage where roasted diced almonds containing splinters were packaged into nut clusters that were incorporated into cereals. The court found that the costs of repackaging the cereal qualified as property damage because "potentially injurious material in a product cause[d] loss to other products with which it is incorporated."

In *Titanium Products, Inc. v. Federal Insurance Co.*,[69] the court held that the insured's product, raw titanium that was used to make screws, which were then used in orthopedic implants and devices, was not sufficiently integrated to constitute property damage. The screws suffered from alloy segregation, i.e., the failure of alloys in the metal to completely melt, causing the alloy to separate and undermine the strength of the product. The court focused on the distinction between coverage for tort liability for physical damage to other persons or property versus the protection from contractual liability of the insured for economic loss caused by defective products. Because the insured's product, raw titanium, was fashioned into screws, it was otherwise unaltered and not appended to other property that was itself damaged.

67. 532 F.3d 1007 (9th Cir. 2008).
68. 93 Cal. Rptr. 2d 364 (2000).
69. 2014 WL 4428324 (N.J. Super. Ct. App. Div. Sept. 10, 2014).

The court distinguished the titanium defect from the facts of *Newark Insurance Co. v. Acupac Packaging Inc.*,[70] in which the insured manufactured foil laminated pacquettes containing cosmetic lotion, which were attached to advertising cards and bound in magazines. The court found coverage because the pacquettes leaked, rendering the cards unusable.

In *Netherlands Insurance Co. v. Main Street Ingredients, LLC*,[71] the court found that damage to a third party's property caused by the incorporation of the insured's defective product triggered coverage. Plainview sold dried milk to Main Street, which in turn sold the dried milk to Malt-O-Meal. In 2009, the Food and Drug Administration found salmonella bacteria on food-contact surfaces used to manufacture dried milk products in Plainview's plant. Plainview issued a product recall notice. Main Street, the insured under Netherland's CGL policy, forwarded the notice to Malt-O-Meal, which then recalled its instant oatmeal that contained the recalled dried milk. Malt-O-Meal sued Main Street and Plainview. Although Netherlands defended Main Street under a reservation of rights, it refused to contribute to a settlement with Malt-O-Meal for $1.4 million. In the subsequent coverage action, the district court found property damage existed because the oatmeal was physically affected by the incorporation of the instant milk manufactured in unsanitary conditions and that the oatmeal was legally unusable. The Eighth Circuit affirmed.

In *National Union Fire Insurance Co. v. Terra Industries, Inc.*,[72] the insured operated a chemical plant that produced fertilizer, which created carbon dioxide as a by-product. It sold the carbon dioxide to beverage manufacturers. In 1998, Terra discovered a leak in its processor that allowed benzene to permeate the carbon dioxide. It had sold substantial quantities of contaminated carbon dioxide that were incorporated into third party manufacturers' products. The court found that the incorporation of contaminated carbon dioxide into consumer beverages constituted an "occurrence" resulting in "property damage."

In *Watts Industries, Inc. v. Zurich American Insurance Co.*,[73] the insureds, which were manufacturers of parts used in municipal water systems, were sued by various municipalities alleging injury to their water systems due to lead contamination resulting from substandard parts. The court held that the plaintiffs' allegations of injury and the claim that substandard parts containing hazardous materials were incorporated into their water systems raised a possibility of covered property damage. However, where products or work containing hazardous materials have been incor-

70. 746 A.2d 47 (N.J. Super. Ct. App. Div. 2000).
71. 745 F.3d 909 (8th Cir. 2014).
72. 346 F.3d 1160 (8th Cir. 2003).
73. 18 Cal. Rptr. 3d 61 (2004).

porated into other products or structures, courts have found immediate harm and physical injury to other property at the moment the incorporation occurred.[74] In *Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co.*, the court held that incorporation of asbestos-containing building material (ACBM) in a building caused immediate physical injury to that building, regardless of whether the ACBM had begun to release asbestos fibers.[75] The court reasoned "because the potentially hazardous material is physically touching and linked with the building, and not merely contained within it, the injury is physical even without a release of toxic substances into the building's air supply."[76]

IV. DAMAGES ARE NOT RESTRICTED TO LEGAL CLAIMS FOR MONEY AND CAN EXTEND TO FORMS OF EQUITABLE RELIEF

In the context of CGL coverage in products liability cases, "damages" covered by the policy are related to relief for the class. Insurers often argue that "damages" should be restricted to payments of legal claims for money.[77] However, the vast majority of jurisdictions have ruled in the opposite direction, reasoning that while the term "damages" may be ambiguous, "[a] standard policy of insurance being the crafty product of insurers who made the policy . . . should be interpreted most strongly against the insurer."[78] In *Omega Flex*, the class complaint requested equitable relief, requiring Omega to notify class members of their right to seek recovery for property damage related to a defective steel tubing product. The court ruled "injunctive relief that requires the insured to incur costs to remedy covered losses is 'damages' within the scope of the policy." This approach is in line with the view that insurance policy language should be interpreted according to how an ordinary policyholder, rather than a lawyer, would understand it.

At the other end of the spectrum, a narrow interpretation limiting "damages" to payments of money ordered by a court has appeared in California.[79] While a minority view, policyholders should be aware that settlements should address the damages issue.

74. *See* Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co., 52 Cal. Rptr. 2d 690 (1996); *Shade Foods, Inc.*, 93 Cal. Rptr. 2d at 364.

75. *See Armstrong*, 52 Cal. Rptr. 2d 690.

76. *See also* USF&G v. Wilkin Insulation Co., 578 N.E.2d 926 (Ill. 1991) (incorporation of ACBM constitutes property damage).

77. *See, e.g.*, Cont'l Ins. Cos. v. N.E. Pharm. & Chem. Co., 842 F.2d 977 (8th Cir. 1988).

78. Sch. Union No. 37 v. United Nat'l Ins. Co., 617 F.3d 554, 563 (1st Cir. 2010).

79. *See* Aerojet-General Corp. v. Commercial Union Ins. Co., 65 Cal. Rptr. 3d 803 (2007) (insurer did not owe a duty to indemnify the policyholder for a settlement that it negotiated with underlying claimant and executed without judicial supervision); Columbia Cas. Co. v. Gordon Trucking, Inc., 758 F. Supp. 2d 909 (N.D. Cal. 2010) (same).

In *Outboard Marine Corp. v. Liberty Mutual Insurance Co.*,[80] the court ruled that equitable relief could constitute damages. The court found coverage for injunctive claims brought by government agencies related to the insured's water pollution. The court rejected the insurers' argument that this was equitable rather than compensatory relief because "the technical difference between equity and law was outdated."[81] Since the policy did not define damages, the court adopted the dictionary definition, which did not distinguish between compensatory damages and the costs of complying with an injunction.

The appellate court gave "damages" its ordinary and popular meaning since the policy could have but did not define the term. The court noted that *Webster's Dictionary* defined "damages" as "the estimated reparation in money for detriment or injury sustained; compensation or satisfaction imposed by law for a wrong or injury caused by a violation of a legal right" and that *Black's Law Dictionary* defined damages as "[m]oney claimed by, or ordered to be paid to, a person as compensation for loss or injury."

In *Zurich American Insurance Co. v. Nokia, Inc.*,[82] the insurers argued that because the plaintiffs were seeking headsets, and not damages, their claims were not covered. They argued that because a headset would be inadequate relief for such injury, the prayer for relief for the cost of a headset is not "damages because of bodily injury." The court was unpersuaded. It found that some of the damages claimed sought compensatory damages, including but not limited to, amounts necessary to purchase headsets. It also held that because the policies do not define the term "damages," damages in the form of a headset neither clearly fell within a policy provision, nor were clearly excluded by the policy, therefore the term was ambiguous.

V. WHERE BODILY INJURY IS ALLEGED

It is not uncommon that, in order to achieve the uniformity necessary for certification as a class, a class action may expressly reject relief for bodily injury or property damage. While this should mean there is no coverage, a few courts have found coverage despite the absence of potentially covered allegations. However, the court in *Steadfast Insurance Co. v. Purdue Frederick Co.* came to a different conclusion. There, the underlying actions alleged deceptive marketing practices allegedly leading to addiction and abuse of the drug OxyContin. The class specifically excluded those seek-

80. 607 N.E.2d 1204 (Ill. 1992).
81. *Id.* at 1209.
82. 268 S.W.3d 487 (Tex. 2008).

ing damages for bodily injury from the class.[83] The court found no duty to defend, explaining that

> [u]ltimately persuasive is the lack of any evidence in the above pleadings to indicate even the possibility that the plaintiffs seek damages 'because of bodily injury.' . . . A careful review of [one] amended complaint shows that the relief sought is restitution/disgorgement of OxyContin-related profits, injunctive relief and attorney's fees. Restitution is certainly a type of money damages, but a fair reading of the pleading is that restitution is sought to compensate for allegedly wrongful marketing and promotional activities, not bodily injury. In [the other complaints], the allegations . . . expressly exclude claims of damages for bodily injury.[84]

In *Plantronics, Inc. v. American Home Assurance Co.*,[85] the court granted the insured's motion for summary judgment, finding that the allegations of noise-induced hearing loss and the packaging's lack of adequate warnings for the insured's Bluetooth headsets alleged damages because of bodily injury. The underlying class actions went to great lengths to describe the noise-induced hearing loss risk engendered through extensive use, and therefore, the bodily injury was not speculative. The court acknowledged that the proof of suffering bodily injury might affect indemnity coverage, but the insurer was "not permitted to duck coverage simply because the complainants sought the tactical advantage of bringing their claims through a class action."[86]

In *HPF, L.L.C. v. General Star Indemnity Co.*,[87] HPF sold a product line, including a product called Herbal Phen-Fen. Suit was filed against HPF under a California statute wherein the plaintiff alleged that HPF violated various California statutes through unlawful labeling, distribution, and promotion. HPF tendered the defense of the complaint to General Star, its CGL insurer, which denied that it had the duty to defend or indemnify HPF in the action because the complaint did not seek damages for bodily injury. HPF settled the claim and filed a declaratory judgment action against General Star. The trial court granted summary judgment in favor of HPF.

On appeal, General Star contended that the summary judgment should not have been granted because the underlying action did not allege and did not seek damages for bodily injury as required by the General Star policy. HPF argued that the underlying complaint did seek damages of

83. 2006 WL 1149202, at *2 (Conn. Super. Ct. Apr. 10, 2006).
84. *Id.* at *3.
85. 2014 WL 2452577, at *4 (N.D. Cal. 2014).
86. *Id.* at *4, n.39.
87. 788 N.E.2d 753 (Ill. App. Ct. 2003).

bodily injury because it was seeking to establish a fund for medical monitoring of all persons who used HPF's Herbal Phen-Fen products.

The appellate court reviewed the allegations in the underlying complaint and found that the essence of the complaint was that HPF misrepresented that its herbal products were proven safe and effective. The court went on to find that the underlying complaint did not make a single allegation that HPF's herbal products caused bodily injury or even that they might cause bodily injury. The court noted that the nature of the underlying complaint alleged a violation of a statute and was not seeking recovery for bodily injury resulting from exposure to toxins.

In *Medmarc Casualty Insurance Co. v. Avent America*,[88] Avent America sold various products to the public for use by toddlers and infants. Unfortunately, those products contained small amounts of bisphenol A (BPA), which, according to a significant amount of research, was shown to be harmful to humans, especially children. Even though Avent America was aware of this research, it still marketed the products both as superior to other similar items and as safe for infants and toddlers.

When the information regarding BPA's harmful effects came to light, a certified class of plaintiffs, in two consolidated actions, sued Avent America, alleging they had suffered economic damages by having to throw away the products once the presence of BPA came to light. These plaintiffs had purchased many of Avent America's baby products based on their belief the products were safe for their children. The plaintiffs also asserted claims for various state unfair trade practices violations, breaches of contract, and unjust enrichment.

Avent America tendered the defense of the underlying class litigation to the insurers. Ultimately, all of the insurance companies filed declaratory judgment actions against Avent America seeking a no-coverage determination. The cases were consolidated, and the insurers moved for either judgment on the pleadings or for summary judgment. All of the parties to the consolidated declaratory judgment action agreed that the plaintiffs' claims did not contain any allegations of physical illness, the cost of future medical monitoring, fear of future injury, or emotional distress. In short, the plaintiffs' claims against Avent America, i.e., that they had to throw away various products containing BPA, amounted simply to a "no-injury product liability claim." The insurers argued that the policies provided coverage only for claims arising out of "bodily injury," and there was no bodily injury in this case. The district court granted judgment for the insurers.

On appeal to the Seventh Circuit, the court held that, even if every factual allegation in the plaintiffs' underlying complaint had been proven to

88. 612 F.3d 607 (7th Cir. 2010).

be true, the plaintiffs could not recover for any "bodily injury." Avent America argued that BPA, even in low levels, must "create" or "cause" some level of bodily harm for the plaintiffs to have reasonably thrown away the products in question and, in turn, this caused them to suffer economic damages. The court rejected that argument because the plaintiffs alleged only economic damages, not any bodily injuries. Consequently, even if BPA were ultimately proven to cause bodily injury in general, the plaintiffs had not suffered, nor alleged, any specific bodily injury.

Avent also claimed that the omission of any allegations of "bodily injury" from the plaintiffs' complaint in the underlying litigation was merely a drafting error or whim on the part of the plaintiffs' attorney. In response, the Seventh Circuit concluded the "omission" was not an error, but instead a strategic decision made because only a very small number of the individual class plaintiffs could potentially have alleged bodily harm. To achieve class certification, the plaintiffs as a whole could allege only common harm, and the only common harm at issue was economic.

Interestingly, the Seventh Circuit noted that the insurers' counsel conceded at oral argument that had the complaint stated a claim for "bodily injury," the insurers would have had a duty to defend. Furthermore, the court stated that if the plaintiffs eventually amended their complaints to allege "bodily injury," the duty-to-defend concession by the insurers' counsel would obligate the insurers to defend Avent America under that situation. Nevertheless, the plaintiffs' present complaint and the underlying factual allegations failed to allege or state a cause of action related to "bodily injury," and the Seventh Circuit concluded that the district court properly found that a duty to defend had not arisen.

In *Zurich American Insurance Co. v. Nokia, Inc.*,[89] Nokia was sued in a number of class actions alleging that radiation emitted by their phones caused biological injury. Although none of the complaints used the term "bodily injury," the court held that allegations of injury at the cellular level, much like the subclinical injuries alleged by plaintiffs who have been exposed to asbestos, were sufficient to allege bodily injury. In *Zurich*, the Texas Supreme Court addressed coverage questions presented by an underlying class action lawsuit wherein the plaintiffs alleged that radio frequency radiation from cell phones caused "biological injury." The plaintiffs sought damages specifically, but not exclusively, in the form of headsets to minimize exposure to the harmful radiation.[90] The court there considered that

> [t]he lengthy complaints assert that the named plaintiffs were exposed to [radiation] from their phones and thus were subjected to "[the radiation's] bio-

89. 268 S.W.3d 487 (Tex. 2008).
90. *Id.* at 489.

> logical effects and the risk to human health arising therefrom" and then discuss numerous studies linking RFR to adverse health consequences, including changes in the brain, headaches, heating behind the ear, sleep problems, and production of high levels of "heat shock proteins."[91]

The court concluded that, in alleging "biological injury" from the radiation, the plaintiffs presented claims that could potentially fall within coverage.[92] The court also concluded that, because the claim for damages was based on the plaintiffs' exposure to radiation, it fell within coverage as alleging claims for bodily injury.[93]

VI. COVERAGE UNDER ADVERTISING INJURY OR PERSONAL INJURY LIABILITY PROVISIONS

In *Battery Solutions, Inc. v. Auto-Owners Insurance Co.*,[94] the claimant brought suit against the insured, with which it had subcontracted for the disposal of waste materials, including lithium batteries, alleging that the insured had improperly disposed of the batteries in China, thereby damaging its goodwill and reputation. The CGL insurer argued that the disparagement did not arise out of the insured's business and was excluded by the breach of contract exclusion. The trial court agreed with the insurer. On appeal, the court noted that the underlying complaint contained no allegation of libel, slander, or disparagement. The Chinese advertisement of the claimant's goods did not meet the definition of a disparagement, "a false and injurious statement that discredits or detracts from the reputation of another's character, property, product or business." The court rejected plaintiff's characterization of the advertisement as disparaging as "wholly based on a hypothetical consumer reaction."

In *Federal Insurance Co. v. Binney & Smith, Inc.*,[95] Binney & Smith settled a class action lawsuit claiming consumer fraud and trade practices violations in the packaging of its Crayola brand crayons, along with breach of express and implied warranties. The putative class consisted of all individual purchasers of Crayola crayons, who alleged that Crayola packaging falsely stated from 1969 to 1986 that the product was "nontoxic and safe for children," while crayons actually contained asbestos fibers. Although the U.S. Consumer Products Safety Commission (CPSC) reported that there was an "extremely low" risk of exposure to children using the crayons, Binney agreed with the CPSC to reformulate its crayons and quickly settled the class action. The class action settlement also addressed refor-

91. *Id.* at 492.
92. *Id.* at 493.
93. *Id.* at 494.
94. No. 311168 (Mich. Ct. App. Mar. 18, 2014) (unpub.).
95. 913 N.E.2d 43 (Ill. App. Ct. 2009).

mulation of the crayons and further required payment of the plaintiffs' attorney fees and publication of certain notices and advertisements.

Federal issued a series of CGL policies to Binney between 1969 and 1996, three of which (in periods commencing 1980, 1983 and 1985) included coverage for "advertising injury claims." Federal filed a coverage action in Illinois state court, seeking declaratory judgment that it had no duty to defend or indemnify the class action. Federal asserted that Binney had not established the reasonableness of the settlement; that the settlement must be allocated between the covered consumer fraud claims and the non-covered warranty claims; and that if Binney could not show what portion of the settlement related to offenses committed during the effective periods of its advertising injury coverage, the entire loss should be allocated pro rata according to each insurer's time on the risk. Binney disagreed and, following a bench trial, prevailed on each of these issues. The Appellate Court of Illinois affirmed that the settlement was reasonable. The court noted that the allegations of false labeling came within Federal's advertising injury risk.

The court rejected Federal's contention that the class action settlement had to be allocated between the covered consumer fraud claim and the non-covered warranty claim. The court reiterated its observation in *Commonwealth Edison Co. v. National Union Fire Insurance Co.*[96] that requiring such allocations would "act[ ] as a chilling effect on the settlement of [the underlying] case" and followed *Commonwealth Edison*'s holding that allocation between covered and non-covered claims was unnecessary where the plaintiff demonstrates that the primary focus of the underlying litigation was a covered loss and it settled in reasonable anticipation of that litigation. Because there was no way to decipher how much, if any, of the class action settlement was attributable to the warranty claims, and doing so would require a mini-trial, the appellate court found sufficient evidence that Binney had settled the class action in reasonable anticipation of liability under the covered consumer fraud count.

The court noted that the coverage was restricted to offenses "committed during the policy period in the course of the named insured's advertising activities." The court noted that such a policy period limitation was exactly what was missing from the insurance contracts at issue in prior Illinois cases that supported imposing joint and several liability on the insurer under the "all sums" rule in that case.

Accordingly, on remand, Binney was required to show an injury arising out of an offense committed during the policy period in the course of its advertising activities, i.e., to delineate which portions of the class action settlement related to class members who had purchased Crayola crayons

96. 752 N.E.2d 555 (Ill. App. Ct. 2001).

during the three relevant policy periods when Federal was on the advertising injury risk. If Binney could not make such a showing, the court directed a pro rata, time-on-the-risk allocation covering the entire thirty-year period when Binney advertised its crayons as non-toxic, such that Federal would bear only one-tenth of the settlement liability based on its three years on the risk.

VII. THE IMPACT OF EXCLUSIONS

A. *Product Recall or "Sistership" Exclusions*

In *Hi-Port, Inc. v. American International Specialty Lines Insurance Co.*, the court considered a claim by an insured that was in the business of providing contract chemical blending, packaging, and distributing services that it was entitled to coverage under its CGL policy for a recall of a batch of antifreeze due to "a latent silicate fallout problem which occurred after the antifreeze had been packaged and distributed."[97] The court concluded that the antifreeze in question met the definition of the insured's "product" under the policy.[98] The court then found that the policy's sistership exclusion precluded coverage as the exclusion "applies to 'product, work, or property' 'withdrawn or recalled from the market or from use . . . because of a known or suspected defect, deficiency, inadequacy or dangerous condition.'"[99]

The sistership exclusion will not apply, however, where the insured does not attempt to remove the product from the market. In *Stark Liquidation Co. v. Florists' Mutual Insurance Co.*, the court considered a dispute between an insurer and an insured where the insured sought coverage for damages arising from diseased apricot trees it sold to a third party.[100] The relevant policy exclusion there stated that the insurance did not apply:

> (a) To property damages to your products or your work performed arising out of such products, or any part thereof;
>
> (b) To damages claimed for the withdrawal, inspection, repair, replacement or loss of use of:
>
> (i) Your products;
>
> . . .
>
> (iii) Any property of which such products or work forms a part, if such products, work or property are withdrawn from the market or from use because of a known or suspected deficiency of them.[101]

97. 22 F. Supp. 2d 596, 597–98 (S.D. Tex. 1997), *aff'd*, 162 F.3d 93 (5th Cir. 1998).
98. *Id.* at 600.
99. *Id.* at 601.
100. 243 S.W.3d 385, 395 (Mo. Ct. App. 2007).
101. *Id.*

The court held that the exclusion did not apply because the insured did not seek coverage for the trees themselves, nor did it recall the trees.[102]

B. *Impaired Property Exclusion*

Courts will sometimes find that incorporation of a "potentially injurious material" into another product, causing loss to the products into which it is incorporated, constitutes property damage.[103] *Shade Foods* involved the discovery of wood splinters in diced almonds processed by the insured but supplied by a third party. The policy in that case contained an exclusion for property damage to impaired property and defined "impaired property" as "tangible property, other than your product or your work that cannot be used or is less useful because: . . . It incorporates your product or your work that is known or thought to be defective, deficient, inadequate or dangerous . . . *if such property can be restored to use by . . . [t]he repair, replacement, adjustment or removal of your product.*"[104] The court found that the exclusion did not apply because the product manufactured from the contaminated diced almonds could not be "restored to use"; at most, the insured could "salvage" the product for some other use but it was "fanciful to suppose that the nut clusters composed of congealed syrups and diced nuts or the boxed-cereal product containing the nut clusters could be somehow deconstructed to remove the injurious splinters and then recombined for their original use."[105]

While it seems indisputably established that damage to the insured's "own product" is excluded from coverage,[106] the "your product" exclusion does not eliminate coverage for consequential damage to third-party property caused by defects in the insured's work or product.[107] There are courts, however, which hold that consequential damages that flow exclusively from excluded property damage are not covered.[108]

102. *Id.*

103. *See* Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc., 93 Cal. Rptr. 2d 364, 376–77 (2000).

104. *Id.* at 377 (emphasis in original).

105. *See* Wis. Label Corp. v. Northbrook P&C Ins., 607 N.W.2d 276 (Wis. 2000) (economic loss did not result from either of the types of damages covered under the policy; therefore, there was no coverage); Trio's, Inc. v. Jones Sign Co., 444 N.W.2d 443 (Wis. Ct. App. 1989) (concluding that lost profits attributable to loss of use of the insured's product were not recoverable because "the insurance policy unambiguously excludes from coverage damage to the insured's product").

106. *See* 49 A.L.R. 6th 169.

107. *See* Wausau Underwriters Insurance Co. v. United Plastics Group, Inc., 512 F.3d 953 (7th Cir. 2008).

108. *See Wis. Label Corp.*, 607 N.W.2d at 276 (economic loss did not result from either of the types of damages covered under the policy; therefore, there was no coverage); *Trio's, Inc.*, 444 N.W.2d at 444 (concluding that lost profits attributable to loss of use of the insured's product were not recoverable because "the insurance policy unambiguously excludes from coverage damage to the insured's product").

There is a split among courts, however, as to whether the "your product" exclusion eliminated coverage for damage to other property caused by the repair and replacement of the faulty work or product.[109]

As an example of how the "insured product" exclusion was applied, in *B&D Contractors, Inc. v. Arwin Window Systems, Inc.*,[110] the court found the defect was the only damage alleged. B&D Contractors installed windows as part of a building renovation project. After installation was complete, the windows began breaking. It was determined that the window frames could not support the weight of the glass window panes. The frames bent under the weight of the glass panes, causing the windows to break. B&D removed and replaced all of the windows, including those windows that had not yet broken. B&D then sued the window manufacturer (Arwin Window Systems), the window frame manufacturer (Graham Architectural Products), and the window frame manufacturer's insurer (Transcontinental Insurance Company) for the replacement cost of the windows.

In the lawsuit, B&D alleged Arwin and Graham provided defective windows. B&D further alleged the Transcontinental policy covered the replacement cost of the windows. Transcontinental moved for summary judgment based on the policy's "your product" exclusion. The Wisconsin Court of Appeals affirmed judgment in favor of Transcontinental.

On appeal, B&D argued the "your product" exclusion did not apply because the damage to the windows was caused by or resulted from a "collapse" of the window frames. The court determined a "collapse" would render the "your product" exclusion inapplicable only if the damage to the window frames was either caused by a collapse or the result of a collapse. First, the window frame damage was not caused by a collapse because the defective window frames caused the collapse. Second, the damage to the window frames resulted in, and not from, the collapse. In other words, the window frames were defective before they were installed; the defects were neither caused by nor resulted from the collapse.

With regard to the "impaired property" exclusion (Exclusion (m)), the purpose is to eliminate coverage for purely economic losses caused when property cannot be used or has been rendered less useful by the incorporation of an insured's product. Obviously, it does not apply when the insured's product has damaged other tangible property or cannot be removed or replaced without damaging other property. The impaired property exclusion is also subject to a "sudden and accidental" exception.

109. *See* 3-16 New Appleman Law of Liability Insurance § 16.06 (Lamden)); Bright Wood Corp. v. Bankers Standard Ins. Co., 665 N.W.2d 544 (Minn. Ct. App. 2003) (damage to other property caused by repairs to insured's product is excluded).

110. 718 N.W.2d 256 (Wis. 2006).

In *Sony Computer Entertainment America, Inc.*, the court examined the scope of Exclusion (m) for "loss of use" property damage arising out of a "defect, deficiency, inadequacy or dangerous condition."[111] Because the loss of use was the result of a defect in Sony's product, it was excluded. The court also rejected Sony's argument that the "sudden and accidental" physical injury exception to the exclusion applied. It found that the allegations provided more support for the theory that the devices deteriorated over time rather than that each class member's device experienced a sudden and accidental physical injury.

In *AOL v. St. Paul*, the court held that coverage for damages caused by the loss of use of the class members' computers was eliminated by the "impaired property" exclusion because the computers were "impaired property."[112] The only defect was in the insured's software product, and once the product was uninstalled, the computers' functionality was restored.

In *Eyeblaster*, the court rejected Federal's reliance on the "damage to impaired property or property not physically injured" exclusion because Federal did not meet its burden of proving that the exclusion applied.[113] First, the court held that plaintiff's computer could not be considered "impaired property" within the meaning of the exclusion because no evidence existed that the computer could be restored to use by removing Eyeblaster's product or work from it. Second, the plaintiff alleged that he unsuccessfully attempted to have the damage to his computer repaired, and thus Federal could not demonstrate that the computer could be restored by the removal of Eyeblaster's product or work.

In *Watts Industries*, the parties agreed that defect in the substandard parts themselves was not covered due to the "your product" exclusion.[114] In focusing on the "impaired property" exclusion, however, Zurich argued that since the municipalities' water systems could be fully restored to use by the replacement of the defective parts, there was no coverage for any replacement costs. Watts argued that the impaired property exclusion "does not apply where the other property [which incorporates the allegedly faulty work or product] has been physically injured."[115] Under the

111. Sony Computer Entm't of Am., Inc. v. Am. Home Assurance Co., 532 F.3d 1007 (9th Cir. 2008).

112. Am. Online, Inc. v. St. Paul Mercury Ins. Co., 207 F. Supp. 2d 459, 461 (E.D. Va. 2002), *aff'd*, 347 F.3d 89 (4th Cir. 2003).

113. Eyeblaster, Inc. v. Federal Insurance Co., 613 F.3d 797 (8th Cir. 2010).

114. Watts Indus., Inc. v. Zurich Am. Ins. Co., 18 Cal. Rptr. 3d 61 (2004).

115. *See* H. WALTER CROSKEY ET AL., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION ¶ 7:1484.3, at 7E-35 (Rutter Group 2003); *see also*, *e.g.*, Gaylord Chem. Corp. v. ProPump, Inc., 753 So. 2d 349, 355 (La. Ct. App. 2000); Standard Fire Ins. Co. v. Chester O'Donley, 972 S.W.2d 1, 10 (Tenn. Ct. App. 1998); Imperial Cas. & Indem. v. High Concrete Structures, 858 F.2d 128, 136 (3d Cir. 1988); Lang Tendons, Inc. v. N. Ins. Co. of N.Y., 2001 WL

reasoning in *Armstrong*, the municipalities alleged physical injury to their water systems through the incorporation of the defective parts, and Zurich did not prove the absence of such injury.[116] Thus, the impaired property exclusion did not apply.

Although Zurich assumed that replacement of the defective parts would cure all problems with the water systems, the allegations of the underlying complaints did not. In addition to seeking replacement of the parts, the municipalities also claimed costs for lead monitoring and abatement. As such, the court found they implicitly alleged that mere replacement of the parts would not fully restore the water systems. As with contamination of the water, Zurich offered no evidence to prove the impossibility of containing contamination of the water systems even after the replacement of the defective parts. Thus, since Zurich could not negate the possibility of physical injury to the municipal water systems by incorporation of the substandard parts, the court affirmed coverage in favor of Watts.

In *U.S. Metals, Inc. v. Liberty Mutual Group, Inc.*,[117] the Fifth Circuit certified two questions of law to the Supreme Court of Texas relating to the interpretation of two product liability exclusions that will have an important effect on future product liability class actions. Although the case does not involve a class action, but rather a commercial dispute between Exxon and U.S. Metals, it deals with the issue of whether defects arising from the incorporation of U.S. Metals' weld neck flanges into Exxon's non-road diesel facilities constituted property damage.

Exxon discovered a leak in one of the installed flanges. It claimed the only way to mitigate its damages was to replace all the flanges. The replacement would require portions of the refineries to be shut down for several weeks, resulting in the loss of use of the refineries.

Liberty Mutual denied coverage to U.S. Metals based on the "your product" and "impaired property" exclusions. Because there is no controlling Texas authority determining whether "physical injury" or "replacement" as used in the two exclusions is ambiguous, the court looked to the Supreme Court of Texas for answers.

228920, at *9 (E.D. Pa. 2001); McKinney Builders II, Ltd. v. Nationwide Mut. Ins. Co., 1999 WL 608851, at *9 (N.D. Tex. 1999); Transcont'l Ins. v. Ice Systems of Am. 847 F. Supp. 947, 950 (M.D. Fla. 1994).

116. Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co., Cal. Rptr. 2d 690 (1996).

117. 589 F. App'x 659 (5th Cir. 2014).

VIII. OTHER ISSUES FOR CONSIDERATION

A. *Voluntary Settlements by the Insured*

Occasionally, an insured may voluntarily settle class action claims or a lawsuit, raising interesting issues for the insurer. In *Lloyd's Syndicate No. 5820 v. AGCO Corp.*, the insured argued that Lloyd's duty to indemnify arose at the time it sent a demand letter to the insurer seeking reimbursement of $410,000 in extended protection plan claims made by consumers of the insured's product, a self-propelled, agricultural spray applicator.[118] Lloyd's argued that the terms of the policy clearly stated that the duty to indemnify arose when the insured was "held legally liable" for the claims, and that the insured's "voluntary reimbursement" of the claims before the entry of judgment was not covered.[119] The court agreed with Lloyd's, holding that the duty to indemnify could not be required until a court determined the insured's legal liability for the underlying claims.

In *Binney & Smith*,[120] the insured was sued in an action that alleged breach of implied warranty of merchantability, violation of the Illinois Consumer Fraud Act and Uniform Deceptive Trade Practices Act, and breach of express warranty. The insured settled the underlying claims, despite the finding that the product at issue (crayons) were safe and nontoxic, because it believed that "any reasonable estimate of the amount of an adverse jury verdict, multiplied by the possibility of it occurring, exceeded the amount for which it was anticipated Binney could settle."[121] The insurer attempted to avoid the duty to defend and indemnify, arguing that the insured settled despite an "absolute defense" to the statutory claims against it and there was no potential that the other claims against it could be covered under the policy. The Illinois Appellate Court agreed with the lower court's ruling that the insured settled the underlying claims "in reasonable anticipation of potential liability in the underlying actions."[122] After concluding that the settlement was reasonable, and therefore the insurer would have a duty to indemnify at least part of the settlement amount, the court remanded to the district court so that the insured could

> define when the various class members who were part of the settlement actually purchased Crayola brand crayons, triggering the advertising injury at issue here . . . [and the insurer] would then be responsible for the portion of the settlement damages that relates to injuries that occurred while the

118. 756 S.E.2d 520 (Ga. 2014).
119. *Id.* at 525.
120. 913 N.E.2d 43, 48 (Ill. App. Ct. 2009).
121. *Id.* at 49.
122. *Id.* at 53.

> Federal policies at issue provided Binney with advertising injury coverage."[123]

The opposite conclusion was reached in *Piedmont Office Realty Trust, Inc. v. XL Specialty Insurance Co.*,[124] which arose in the context of a federal securities class action suit in which the plaintiffs sought over $150 million against Piedmont Office Realty Trust. Piedmont was insured under a primary policy from Liberty Surplus Insurance Company and an excess policy from XL Specialty Insurance Company. Each policy had a limit of $10 million for both defense and indemnity. The district court dismissed the class action, and while the appeal was pending, Piedmont, which had already exhausted the full limits of the primary policy and $4 million of the excess with defense costs, sought XL's consent to settle the claim for the remaining $6 million. XL agreed to contribute only $1 million towards the settlement.

Piedmont went forward without XL's consent to settle the underlying lawsuit for $4.9 million and then filed suit against XL for breach of contract and bad faith failure to settle. The district court dismissed the complaint. On appeal, the Eleventh Circuit certified three questions to the Georgia Supreme Court: (1) whether Piedmont was "legally obligated to pay" the $4.9 million that it agreed to pay in settlement, pursuant to the XL policy; (2) whether the XL policy's "consent-to-settle" clause barred Piedmont from bringing suit for breach of contract and bad faith, or whether the court must first determine if consent to settlement was unreasonably withheld; and (3) whether Piedmont's complaint was properly dismissed.

Relying primarily upon *Trinity Outdoor, LLC v. Central Mutual Insurance Co.*,[125] the Georgia Supreme Court found that the consent-to-settle clause prohibited Piedmont from settling under the circumstances in which XL had not agreed to the settlement. The court further refused to find that XL was estopped from insisting that Piedmont had been required to obtain consent because XL had not "wholly abandoned" Piedmont, but instead had provided Piedmont with a defense throughout the underlying proceedings. Accordingly, the Georgia Supreme Court answered the question, finding that Piedmont could not recover the proceeds of the settlement from XL absent consent or a judgment against Piedmont after an actual trial.

Although not a class action, in *Rosalind Franklin University of Medicine and Science v. Lexington Insurance Co.*,[126] a complaint was brought by fifty

123. *Id.* at 58.
124. 771 S.E. 2d 864 (Ga. 2015).
125. 679 S.E.2d 10 (Ga. 2009).
126. 8 N.E.3d 20 (Ill. Ct. App. 2014).

former vaccine patients who claimed that the defendant's decision to discontinue a vaccine program put their lives at risk. The former patients sought injunctive relief as well as damages for breach of fiduciary duty, breach of contract, unjust enrichment and disgorgement, violation of the Illinois Consumer Fraud and Deceptive Business Practices Act, common law fraud, and negligence. Noting that the insurer's claims representative had participated in the defense and was apprised of settlement discussions, the court held the consent-to-settle condition would not be applied where the insurer had waived reliance on consent by failing to timely raise it in a reservation of right. Lexington issued primary and excess healthcare liability policies to Rosalind. Lexington did not raise the consent-to-settle provision in its reservation of rights letter or during the course of settlement discussions. When it subsequently issued its first and only reservation of rights letter, it did not indicate that it intended to pursue a voluntary payment defense based on the settlement agreement or advise its insured not to settle the case. Notwithstanding multiple opportunities to raise the issue of consent to settle or the voluntary payments provision, Lexington declined to do so until after the settlement had been executed. On these facts, the court held that it would be inequitable to allow Lexington to raise this defense. Accordingly, the appellate court affirmed the trial court ruling that Lexington waived its voluntary payment defense.

In two recent cases, the courts reviewed the contrary results followed in different jurisdictions, indicating that there does not seem to be any majority rule. In *Klepper v. ACE American Insurance Co.*,[127] the Indiana Court of Appeals followed those cases that apply the consent-to-settle condition. The case arose out of an underlying class action against Pernod Ricard USA, LLC, d/b/a Seagram Lawrenceburg Distillery, for alleged nuisance, negligence, trespassing, and illegal dumping stemming from the release of ethanol from a distillery owned and operated by Pernod.

During the relevant time periods, Pernod was insured under commercial general liability policies issued by Ace American Insurance, Inc. and XL Insurance America. Pernod tendered the class action to both ACE and XL for coverage. XL provided Pernod with a defense and ACE ultimately agreed to contribute 49 percent of Pernod's defense costs, subject to a full reservation of its rights to dispute coverage under its policy. During settlement discussions, XL and Pernod asked ACE to contribute $1 million toward a settlement, but ACE refused and offered to contribute only $250,000. ACE subsequently attended a meditation for the underlying action, but left before it was concluded.

127. 999 N.E.2d 86 (Ind. Ct. App. 2013).

After ACE left the mediation, the class, XL, and Pernod reached a settlement whereby judgment would be entered against Pernod in the amount of $5.2 million. Specifically, the parties agreed that Pernod would contribute $1.2 million, and XL would contribute $1 million to a common fund for the immediate use and benefit of the class. The remaining $3 million was to be collected from ACE "to the extent the damages fall within the scope of ACE Commercial General Liability Policy. . . ." The class agreed to release Pernod and XL from any claims and to dismiss its claims against Pernod with prejudice upon receipt of the $2.2 million payment from Pernod and XL. The trial court approved the settlement, but adopted a finding by a special master that as a matter of law, Pernod breached its obligation by entering the agreed judgment without the consent of ACE.

On appeal, ACE argued that the reasoning as set forth in *American Family Mutual Insurance Co v. C.M.A. Mortgage, Inc.*[128] supported its position. The class, on the other hand, argued that *Midwestern Indemnity Co. v. Laikin*,[129] among other cases, supported its position. The appellate court noted that the insurer's breach and abandonment of the insured was clearly significant to the *Laikin* court's analysis of whether an insurer is collaterally estopped from relitigating the issues of liability and damages. In this regard, the appellate court found that ACE's refusal to contribute more toward the settlement agreement did not constitute an abandonment of its insured. Accordingly, the appellate court followed the rationale in *C.M.A.* and held that ACE was allowed to rely on the policy's "voluntary payment" and "legally obligated to pay" provisions, which precluded coverage for the underlying settlement under the ACE policy.

Although reviewing the contrary results, the Pennsylvania Supreme Court ended up on the side of the insured in a dispute as to whether to enforce the consent-to-settle condition. In *Babcock & Wilcox Co. v. American Nuclear Insurers*,[130] Babcock & Wilcox Co. and Atlantic Richfield Company (collectively, BWC) were sued by a class of plaintiffs who claimed to have been injured or damaged by nuclear power plant emissions. The defendants tendered their defense to their insurers, which defended under a reservation of rights. In 2009, BWC settled with the class plaintiffs for $80 million. The insurers refused to consent to the settlement, believing the case had a strong likelihood of a defense verdict. They denied coverage, based on BWC's violation of the cooperation and consent-to-settlement provisions of the relevant policies.

128. 682 F. Supp. 2d 879, 881 (S.D. Ind. 2010).
129. 119 F. Supp. 2d 831, 833 (S.D. Ind. 2000).
130. 131 A.3d 445 (Pa. 2015).

The Pennsylvania Supreme Court, in a lengthy decision, considered various approaches other courts had taken in resolving this question. One approach was represented by *United States Auto Association v. Morris*,[131] in which the court held the insurer should cover the settlement, notwithstanding its objection, "so long as coverage applies and the settlement is fair and reasonable and entered in good faith."[132] A second approach, reflected in *Vincent Soybean & Grain Co. v. Lloyd's Underwriters*,[133] was that "the obligation to pay the settlement could only be imposed on [an] insurer if it acted in bad faith in refusing to settle."[134]

A third approach was taken in *Taylor v. Safeco Insurance Co.*,[135] in which the court allowed an insurer to reserve rights, but would give the insured the choice of whether to accept the insurer's defense under reservation or defend itself at its own cost. If the insured accepted defense under reservation, it would be bound by the insurer's decision on whether to settle. If the insured refused the insurer's defense and elected to defend itself, it would retain control of the settlement decision. If coverage was later found, the insurer could not challenge the settlement unless it was unfair, unreasonable, or collusive.

The trial court initially sided with the insurers and adopted the second of these approaches, ruling that an insurer may deny coverage for any claim settled over its legitimate, good faith objections, but then reconsidered. Siding with BWC, it adopted the first approach, i.e., the *Morris* "fair and reasonable" standard. The Pennsylvania Supreme Court held that an insured may accept a settlement over an insurer's refusal to consent when the insurer is defending subject to reservation of rights and "where the settlement is fair, reasonable, and non-collusive" from the perspective of "a reasonably prudent person in [the insureds'] position . . . in light of the totality of the circumstances." The court suggested, however, that an insurer could avoid this outcome by withdrawing its reservation of rights, agreeing to defend without reservation, and covering the amount of any resulting judgment. Moreover, the court noted, even if the insurer declined to withdraw its reservation, the insurer would only be responsible for paying the settlement if coverage was eventually determined to apply.

Finally, in a non-class action case that introduced whether the element of prejudice should be considered in applying the consent-to-settle condition, the Nebraska Supreme Court concluded that, based on the fact that the insured did not tender the claim until after the defense was complete

131. 741 P.2d 246 (Ariz. 1987).
132. *Morris*, 131 A.3d at 448.
133. 246 F.3d 1129 (8th Cir. 2001).
134. *Morris*, 131 A.3d at 448.
135. 361 So. 2d 746 (Fla. Dist. Ct. App. 1978).

and a binding settlement was agreed to, the insurer was prejudiced as a matter of law and was not liable to reimburse the insured. In *Rent-A-Roofer, Inc. v. Farm Bureau Property & Casualty Insurance Co.*,[136] the insured, Rent-A-Roofer, Inc., was sued by National Research Corporation (NRC) for allegedly failing to construct and renovate a property in a workmanlike manner. Rent-A-Roofer hired its own counsel and proceeded to settle with NRC in August 2011.

Rent-A-Roofer was insured by Farm Bureau Property & Casualty Company under a CGL policy. Rent-A-Roofer did not tender the NRC lawsuit to Farm Bureau prior to the settlement. According to Rent-A-Roofer, it had been the subject of a 2007 lawsuit containing somewhat similar allegations but different parties, for which Farm Bureau had denied coverage based on the "your work" exclusion. Based on that experience, Rent-A-Roofer did not believe there was coverage for the NRC claim. Nonetheless, on September 12, 2011, Rent-A-Roofer notified Farm Bureau of the NRC lawsuit and settlement and sought coverage for the cost of the defense and settlement. Farm Bureau denied coverage, asserting that Rent-A-Roofer had breached both the CGL's notice provision as well as the voluntary payments provision.

The trial court concluded that Farm Bureau had to demonstrate it was prejudiced by Rent-A-Roofer's failure to provide notice and breach of the voluntary payments provisions. The court found that when both the notice provision and the voluntary payments provisions are breached by failing to give an insurer an opportunity to take part in a settlement, there is prejudice as a matter of law.

The Nebraska Supreme Court addressed whether prejudice was the standard for avoiding coverage based on a breach of the voluntary payments provision. After surveying the different results among the states, some requiring prejudice and others not, the court concluded that the purpose of the voluntary payments provision was similar to notice provisions: to allow the insurer an "opportunity to protect itself and its insured by investigating any incident that may lead to a claim under the policy, and by participating in any resulting litigation or settlement discussions."[137] Given the similarity, the court concluded that, like a late notice defense, an insurer must demonstrate prejudice to avoid coverage based on a breach of the voluntary payments provision.

Because the insured did not tender the claim until after the defense was complete and a binding settlement was agreed to, the court found that Farm Bureau was prejudiced as a matter of law. The court concluded by addressing Rent-A-Roofer's assertion that its duty to notify Farm

136. 869 N.W.2d 99 (Neb. 2015).
137. *Id.* at 106.

Bureau of the claim was waived when Farm Bureau declined coverage of the prior similar claim. The court disagreed, noting that the prior claim involved "a different occurrence, different parties, and difference allegations."[138]

B. *Exclusions Will Not Create Coverage Where No Affirmative Coverage Otherwise Exists*

While this seems like a simple proposition, the Ninth Circuit in 2008 ruled that carve-back provisions in a policy exclusion do not create coverage where coverage does not otherwise exist. In *Sony Computer Entertainment of America*, the insured was sued in a class action suit alleging that the PlayStation 2 home entertainment system "suffered from an 'inherent'or 'fundamental' design defect that rendered them unable to play DVDs and certain game discs."[139] The complaint also alleged false advertising.[140] The court found that, because there was no coverage for the underlying claims, a provision excluding false advertising that contained a carve-back provision did not *create* coverage where none otherwise existed.[141] The court described the relevant analysis as follows: "If coverage exists, then the court considers whether any exclusions apply. If coverage does not exist, the inquiry ends. The exclusions are no longer part of the analysis because they cannot expand the basic coverage granted in the insuring agreement."[142] Courts in other states have reached the same conclusion.[143]

Although it is not a products liability class action, *K2 Investment Group, LLC v. American Guarantee & Liability Insurance Co.* also stands for the proposition that coverage cannot be created through estoppel.[144] The New York Court of Appeals heard reargument after a motion by the defendant.[145] The court reversed its affirmance of summary judgment in favor of the plaintiff, reasoning that an insurer's breach of a duty to defend does not preclude it from relying on a policy exclusion that does not depend on facts established in the underlying litigation.[146] In other words, an insurer is not estopped from asserting an exclusion as a defense to

138. *Id.* at 107.

139. Sony Computer Entm't of Am., Inc. v. Am. Home Assurance Co., 532 F.3d 1007, 1011 (9th Cir. 2008).

140. *Id.*

141. *Id.* at 1017–18.

142. *Id.* at 1017 (quotation omitted).

143. *See, e.g.*, Hawkeye-Sec. Ins. Co. v. Bob Propheter Constr., L.L.C., 2002 WL 31176183, at *8 (N.D. Ill. Sept. 30, 2002) (stating that an insured may not "attempt to use an exclusion endorsement to expand coverage beyond the basic grant of coverage set forth in the coverage agreement").

144. 6 N.E.3d 1117, *reargument denied*, 10 N.E.3d 1146 (N.Y. 2014).

145. *Id.* at 1119.

146. *Id.*

the duty to indemnify even where it breached the duty to defend as long as the defense is based on facts other than those on which the insurer wrongfully denied defense.

CONCLUSION

There is no limit to the number of cases dealing with coverage for consumer class action products liability actions. Finding coverage for these cases is usually in the detail of what plaintiffs allege in their pleadings, the damages they claim, and the remedies they seek. Coverage can also be affected by how settlements are structured and negotiated. Many of the above cases that did not find coverage contain the clues for how to change the outcome, if counsel for the class and the insured are considering insurance in the pleading and settlement stages.