I. INTRODUCTION

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

Liability insurance has long been the principal vehicle through which businesses seek shelter from the "slings and arrows of outrageous fortune."[1] Before 1940, businesses could obtain liability insurance only through a maze of business-specific policies, e.g., Owners', Landlords' and Tenants' Liability policies, Manufacturers' and Contractors' Liability policies, Owners' and Contractors' Protective Liability policies, Elevator policies, and Contracts policies.[2] Each policy covered specific hazards and locations and excluded all others. Single line businesses needed to purchase multiple policies each time they acquired a new location or changed their location. Multi-line businesses were forced to purchase multiple policies to cover their various endeavors. Liability insurance coverage was cumbersome.

The insurance industry prepared the first standard general liability insurance policy in 1940, combining certain historically distinct forms of coverage in a single policy and providing automatic coverage for new locations and business activities. This standard form has been revised many times since 1940, most significantly in 1973 and 1985, and most recently in 2004.[3] For the last 34 years, the most commonly used contracts have been a series of standard forms drafted by the ISO.[4] The ISO is a national rating and service organization to which a substantial number of the leading property and casualty insurers subscribe.[5] Some insurers modify the ISO CGL forms, but generally the industry follows

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[1] William Shakespeare, *The Tragedy of Hamlet*, Act III, sc. 1.

[2] For a short history of the development of standard insurance policies, from which this discussion was taken, see George H. Tinker, *Comprehensive General Liability Insurance - - Perspective and Overview*, Fed. of Ins. Couns. Q., Vol. 25, No. 3, at 217, 220 (Spring 1975).

[3] Copies of the 1973, 1986, 1998, 2001 and 2004 versions of the CGL Policy are included in the Appendix to this Guide.

[4] The insurance industry has long used rating bureaus to draft standard policies. The ISO was formed in 1971. Previously, the Insurance Rating Board, the National Bureau of Casualty Underwriters, and the National Bureau of Casualty and Surety Underwriters developed standard liability policies.

[5] In *Hartford Fire Ins. Co. v. Cal.*, 509 U.S. 764, 772, 113 S. Ct. 2891 (1993), the Court explained the purpose of ISO:

> ISO develops standard policy forms and files or lodges them with each State's insurance regulators; most CGL insurance written in the United

the current standard forms. The ISO's 1973 edition, known as the Comprehensive General Liability policy, formed the foundation of the available coverage for the next 13 years. In 1976, the ISO published the Broad Form Comprehensive General Liability Endorsement (hereinafter "BFCGL"), which included twelve extensions of coverage that previously had to be purchased separately.[6] In 1986, the ISO introduced a new form known as the Commercial General Liability policy.[7]

The 1973 Comprehensive General Liability policy began with a broad grant of coverage followed by exclusions restricting the coverage. Three documents comprised the basic policy: the declaration page;[8] the "jacket," which contained the definitions and provisions common to all aspects of the policy; and the CGL "coverage part," which contained the insuring agreement, the exclusions, the "persons insured" section, the limits of liability and the policy territory. Other coverages could be added by endorsement, such as the broad form comprehensive liability endorsement and the products hazard endorsement.

The 1986 ISO Commercial General Liability policy is the most widely used general liability policy form today. The Commercial General Liability Policy rendered the traditional BFCGL obsolete by combining in one policy most of the coverages previously created by attaching the BFCGL Endorsement to the 1973 Comprehensive General Liability Policy.[9] Further, it contains significant changes in the trigger of coverage provision and in

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> States is written on these forms. . . . For each of its standard policy forms, ISO also supplies actuarial and rating information: it collects, aggregates, interprets, and distributes data on the premiums charged, claims filed and paid, and the defense costs expended with respect to each form and on the basis of these data it predicts future loss trends and calculates advisory premium rates. Most ISO members cannot afford to continue to use [an ISO] form if ISO withdraws these support services.

[6] The coverage included broad form property damage coverage, contractual liability coverage, personal injury and advertising injury liability coverage, medical payments coverage, host liquor law liability coverage, fire legal liability coverage, incidental medical malpractice liability coverage, non-owned watercraft liability coverage, limited worldwide liability coverage, employees as insureds coverage, extended bodily injury coverage, and automatic coverage of newly acquired organizations.

[7] In 1986, ISO introduced a major revision of the CGL policy (which was copyrighted in 1985). Several revisions to the 1986 form have been issued since that date. The 1986 and subsequent versions are collectively referred to hereinafter as the "1986 ISO CGL" except where indicated.

[8] The declaration page may be a typewritten document or a preprinted form with typewritten entries. It usually contains the identity of the "named insured(s)," the policy number, the types of coverage selected, the amount of the deductible, and a list of the forms that are included in the policy. A policy may contain one declaration page for all coverage or separate pages for separate coverages, such as liability, property, inland marine, and crime coverage.

[9] A Broad Form coverage is available.

the pollution exclusion. The policy is offered with either an "occurrence" or a "claims-made" trigger.

The 1986 ISO "occurrence" form consists of five parts. Section I contains the coverages: Coverage A (bodily injury and property damage liability), Coverage B (personal and advertising injury liability), and Coverage C (medical payments). Section II describes "Who is an Insured." Section III concerns the "Limits of Insurance." Section IV contains the conditions. Section V contains the definitions.

The 1986 ISO "claims-made" form consists of six parts. The first four sections are the same as in the "occurrence" form. Section V of the claims-made policy concerns the "Extended Reporting Period," and Section VI contains the definitions.

Both formats of the 1986 ISO policy are otherwise the same. Unlike the 1973 ISO policy, there is no jacket.

This Guide provides an introduction to the 1973 and 1986 ISO policies, along with references to Maryland and out-of-state case law, as well as to secondary sources concerning major provisions. The focus is on coverage for accidental bodily injury and property damage, which is the primary focus of the 1973 ISO form and is contained in Coverage Part A of the 1986 form. The Personal and Advertising Injury Liability Coverage (Part B), Medical Payments (Part C), and Supplementary Payments provisions of the 1986 ISO form are beyond the scope of this Guide. We begin by examining the insuring agreement, move to exclusions, and conclude with the conditions.

II. INSURING AGREEMENT AND DEFINITIONS

The CGL, like most liability policies, starts with a broad grant of coverage in the insuring agreement and then restricts coverage with exclusions. The insuring agreement provides coverage for accidental bodily injury and property damage that occurs during the policy period. It also contains provisions concerning the duty to defend and the duty to indemnify.

The insuring agreement of the 1973 ISO policy[10] reads, in pertinent part:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of

[10] For a complete copy of the 1973 version of the CGL policy, see Appendix A.

A. bodily injury or

B. property damage

to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage . . . and may make such investigation and settlement of any claim or suit as it deems expedient . . . .[11]

The 1986 ISO policy[12] insuring agreement reads, in pertinent part:

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. . . . This insurance applies only to "bodily injury" and "property damage" which occurs during the policy period. The "bodily injury" or "property damage" must be caused by an "occurrence". . . . We will have the right and the duty to defend any "suit" seeking those damages. . . . We may investigate and settle any claim or "suit" at our discretion.

The 2001[13] and 2004[14] versions of ISO's CGL incorporate the "known loss" provisions of the 1999 "known loss" endorsement CG 0057. It provides, in pertinent part:

b. This insurance applies to "bodily injury" and "property damage" only if:

* * *

(3) Prior to the policy period, no insured listed under Paragraph 1. of Section II – Who Is An Insured and no "employee" authorized by you to give or receive

[11] In the 1973 ISO policy, terms which are defined appear in bold face type in the policy. In the 1986 ISO policy, defined terms appear in quotation marks.

[12] For a complete copy of the 1986 version of the CGL policy, see Appendix B.

[13] For a complete copy of the 2001 version of the CGL policy, see Appendix D.

[14] For a complete copy of the 2004 version of the CGL policy, see Appendix E.

notice of an "occurrence" or claim, knew that the "bodily injury" or "property damage" had occurred, in whole or in part. If such a listed insured or authorized "employee" knew, prior to the policy period, that the "bodily injury" or "property damage" occurred, then any continuation, change or resumption of such "bodily injury" or "property damage" during or after the policy period will be deemed to have been known prior to the policy period.

c. "Bodily injury" or "property damage" which occurs during the policy period and was not, prior to the policy period, known to have occurred by any insured listed under Paragraph 1. of Section II – Who Is An Insured or any "employee" authorized by you to give or receive notice of an "occurrence" or claim, includes any continuation, change or resumption of that "bodily injury" or "property damage" after the end of the policy period.

These insuring agreements obligate the insurer to investigate any claim or suit, to defend the insured, and to indemnify the insured for damages. The duty to indemnify raises numerous issues. Is an event a covered accidental "occurrence" or an excluded intentional injury? What are the limits of "property damage" and "bodily injury"? Did the "property damage" or "bodily injury" take place during the policy period and "trigger" the policy? When is a claims-made policy triggered? Does the term "damages" include equitable relief? Who is an insured? How do you determine the number of occurrences?

As mentioned above, the duty to defend is a separate duty from the duty to indemnify. Where the costs of litigation exceed the costs of indemnity, the duty to defend can be more valuable than the duty to indemnify. Thus, the duty to defend is sometimes referred to as "litigation insurance."[15]

[15] *See Brohawn v. Transamerica Ins. Co.*, 276 Md. 396, 409-10, 347 A.2d 842 (1975) (observing that although the policy is referred to as liability insurance, it is litigation insurance as well, protecting the insured from the expense of defending

A. DEFINITION OF OCCURRENCE

The policy definition of "occurrence" has changed over the years. Before 1966, most liability policies provided coverage for bodily injury or property damage "caused by an accident."[16] The standard policy's insuring agreement was amended in 1966 to respond to "occurrences" rather than "accidents," in response to court decisions which required accidents to be sudden in order to fall within coverage.[17]

"Occurrence" was defined in the 1966 CGL policy to broaden coverage to include "an accident, including injurious exposure to conditions. . . ."[18]

Bodily injury and property damage usually (but not always) occur immediately upon the happening of an accident (e.g., an auto collision or "slip and fall"). However, not all accidents are sudden; some occur over a period of time.[19] Hence, "continuous and repeated" was added to the phrase "exposure to conditions" in the definition of "occurrence" during the 1973 revisions to clarify that the injury or damage need not happen abruptly.[20]

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suits brought against it). For an excellent discussion of the duty to defend under Maryland law, see Andrew Janquitto, *Insurer's Duty to Defend in Maryland*, 18 U. Balt. L. Rev. 1 (Fall 1988).

[16] *See, e.g., State Farm Mut. Auto Ins. Co. v. Treas*, 254 Md. 615, 255 A.2d 296 (1969); *Glens Falls Ins. Co. v. Am. Oil Co.*, 254 Md. 120, 254 A.2d 658 (1969); *Harleysville Mut. Cas. Co. v. Harris & Brooks, Inc.*, 248 Md. 148, 235 A.2d 556 (1967); *Haynes v. Am. Cas. Co.*, 228 Md. 394, 179 A.2d 900 (1962).

[17] An "accident" is "a happening; an event that takes place without one's foresight or expectation; an event which proceeds from an unknown cause, or is an unusual effect of a known cause, and therefore not expected. Webster's Twentieth Century Dictionary. *See Am. Home Assur. v. Osbourn*, 47 Md. App. 73, 80, 422 A.2d 8 (1980); *Ed. Winkler & Son, Inc. v. Ohio Cas. Ins. Co.*, 51 Md. App. 190, 194, 441 A.2d 1129 (1982); *see also Upjohn Co. v. New Hampshire Ins. Co.*, 476 N.W.2d 392, 408 (Mich. 1991) (describing the history of the provision); *Just v. Land Reclamation, Ltd.*, 456 N.W.2d 570, 573-75 (Wis. 1990) (same).

[18] *See, e.g., Am. Home Assur. v. Osbourn*, 47 Md. App. 73, 80, 422 A.2d 8, 13 (1980); *see generally* 7A J. Appleman, *Insurance Law and Practice*, § 4492 (Berdal ed. 1979 & 2003 Cum. Supp.); *see also* Tinker, *supra* note 2, at 254-56. In 1972, the definition was changed to broaden coverage to the definition used in the 1973 CGL. *See* Appleman, *supra*.

[19] *See, e.g., Reliance Ins. Co. v. Mogavero*, 640 F. Supp. 84, 86 (D. Md. 1986) (construction defects); *Steyer v. Westvaco Corp.*, 450 F. Supp. 384, 389-90 (D. Md. 1978) (air pollution); *Harford Co. v. Harford Mut. Ins. Co.*, 327 Md. 418, 435-36, 610 A.2d 286, 294-95 (1992) (air pollution); *Lloyd E. Mitchell, Inc. v. Md. Cas. Co.*, 324 Md. 44, 58-60, 595 A.2d 469, 477-78 (1991) (asbestos exposure).

[20] Tinker, *supra* note 2, at 256-57. Tinker states that "the decision . . . to take the suddenness out of accident and to incorporate coverage for continuous and repeated exposure within the standard provisions" began with the 1966 revision. The phrase "injurious exposure to conditions" was used. *Id*. at 256.

In the 1973 ISO CGL policy, "occurrence" is defined as follows:

> "Occurrence" means an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.

In the 1986 ISO CGL policy, "occurrence" is defined as follows:

> "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

Whether an injury is accidental appears to be a simple concept, but it has proven difficult to apply. In *Sheets v. Brethren Mut.*,[21] the Court of Appeals of Maryland considered the term "accident" in the context of a farm owner's general liability policy.[22] In that case, insured sellers of real estate sought a declaratory judgment that their insurer had a duty to defend and indemnify them in the buyer's lawsuit alleging negligent misrepresentation that a septic system was in good working order. The Court rejected an objective foreseeability test for determining whether an event was accidental, holding that:

> [A]n act of negligence constitutes an "accident" under a liability insurance policy when the resulting damage was "an event that takes place without [the insured's] foresight or expectation." *Harleysville v. Harris & Brooks*, 248 Md. at 154, 235 A.2d at 559 (citation omitted). In other words, when a negligent act causes damage that is unforeseen or unexpected by the insured, the act is an "accident" under a general liability policy.[23]

In reaching this decision, the Court specifically disapproved of the decision in *Ed. Winkler & Son, Inc. v. Ohio Cas. Ins. Co.*,[24] which adopted an objective test for "accident," and *I.A. Constr. Corp. v. T & T Surveying*,[25] which followed *Ed. Winkler & Son, Inc*.[26]

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[21] 342 Md. 634, 679 A.2d 540 (1996).

[22] *See* Gregory T. Lawrence, Sheets v. Brethren Mutual: *Maryland's High Court Misconstrues CGL to Cover Excluded Economic Loss Caused by Negligent Misrepresentation*, 27 U. Balt. L. Rev. 189 (Fall 1997); H. Brent Brennenstuhl, Annotation, *Negligent Misrepresentation As "Accident" or "Occurrence" Warranting Insurance Coverage*, 58 A.L.R. 5th 483 (1998).

[23] 342 Md. at 652, 679 A.2d at 548.

[24] 51 Md. App. 190, 441 A.2d 1129 (1982).

[25] 822 F. Supp. 1213 (D. Md. 1993).

Sheets makes clear that the accidental nature of an event is judged by a subjective standard, i.e., the accident may have been foreseeable from an objective standard, but must not have been foreseen by the insured.[27] The mere objective foreseeability of an accident does not make an event intentional. Foreseeability is also an element of negligence. Thus, if objectively foreseeable injury were excluded, the liability policy would lose its purpose, because it would always exclude coverage for negligence.

1. Negligent Misrepresentation

The Court of Appeals held, in *Sheets, supra*, that an allegation of negligent misrepresentation may allege an accident and, hence, an "occurrence" within the meaning of a liability policy.[28] However, there may be other obstacles to coverage.[29]

2. Defective Workmanship

Construction cases frequently cause considerable controversy concerning whether faulty or defective work constitutes accidental or expected property damage. The CGL

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[26] *Sheets*, 324 Md. at 654; 679 A.2d at 550. In *Ed. Winkler*, which involved an action for slander, malicious prosecution and false arrest, the plaintiff alleged that she was "wrongfully accused by [the insured jewelry store owner] of stealing a $600.00 diamond and substituting for it a $20.00 zircon." *Ed. Winkler,* 51 Md. App. at 191. The supposed zircon turned out to be a diamond and the charges were dropped. The Court found that the insured's acts "were committed consciously and deliberately, without the unexpected intervention by any third force; and. . . the likely (and actual) effect of those acts was well within the insured's foresight and anticipation. Hence, the [Complaint] did not allege an accident or an occurrence." *Id*. at 195. Although the Court was interpreting a contract, it applied a traditional tort test, i.e., "natural and probable consequences," to determine whether an event was an accident or intentional. The factual allegations in *Ed. Winkler* made the alleged personal injury much more than merely foreseeable. The tort plaintiff was alleging intentional torts--false arrest and malicious prosecution-- and also was pursuing an action for slander *per se*, specifically, an accusation of theft. Hence, the injurious character of the alleged injury was self-evident. *See, e.g., Metromedia Inc. v. Hillman*, 285 Md. 161, 163-64, 400 A.2d 1117 (1979) (where words themselves impute defamatory character, no extrinsic evidence as to defendant's knowledge of or reckless disregard as to their falsehood is required); *Jacron Sales Co., Inc. v. Sindorf*, 276 Md. 580, 350 A.2d 688 (1976) (slander may be either an intentional or negligent tort). In *Ed. Winkler*, the injury to the plaintiff was either purposeful or self-evident.

[27] *Sheets*, 342 Md. at 651-52, 679 A.2d at 548-49.

[28] *Id.* at 658, 679 A.2d 540 at 551. *See also Mitchell, Best & Visnic, Inc. v. Travelers Prop. Cas. Corp*., 121 F. Supp. 2d 848 (D. Md. 2000) (under Md. law custom home buyer's negligent misrepresentation claim against builder alleged an "accident" and, thus, a covered occurrence).

[29] *See generally* Gregory T. Lawrence, Sheets v. Brethren Mutual: *Maryland's High Court Misconstrues CGL to Cover Excluded Economic Loss Caused by Negligent Misrepresentation*, 27 U. Balt. L. Rev. 189 (Fall 1997); H. Brent Brennenstuhl, Annotation, *Negligent Misrepresentation As "Accident" or "Occurrence" Warranting Insurance Coverage*, 58 A.L.R. 5th 483 (1998).

policy requires that the loss be fortuitous and not the expected result of a breach of contract. The definition of "occurrence" requires an accident. An "accident" is a negligent act that causes unforeseen or unexpected damage.

Courts around the country and courts purporting to apply Maryland law reach different results in determining whether defective work constitutes an "occurrence."

Lawsuits usually allege breach of contract and breach of warranty along with negligence, so some courts reason that when a developer or contractor constructs a poor-quality building in breach of its contract, it is not an accident and, thus, not an "occurrence." This analysis is based on the idea that when a building is created, it is created with all of its warts and defects – no event has happened which results in damage to the building that may be described as an "occurrence." These courts reason that defective construction or damage to property within the scope of what the insured contracted to build is not an "occurrence." Courts applying this analysis seem more likely to apply it when the loss is to the insured's own work.

Other courts take a different approach, reasoning that where the "property damage" is neither expected nor intended by the insured, it is an "occurrence." Courts seem more likely to reach this result when there is damage to property other than that of the insured.

Many of the courts addressing this issue analyze the substance of the allegations and reach their conclusions regardless of the form of the cause of action.

Several insurance coverage decisions applying Maryland law have analyzed the term "expected" in the context of construction contracts.[30]

In *Lerner Corp. v. Assur. Co. of Am.,*[31] the Court of Special Appeals analyzed when damages are "expected" under the terms of a CGL policy. The plaintiffs were a developer and construction manager who built and sold a building to the United States. The contract of sale between the plaintiffs and the United States (General Services Administration) ("GSA") provided that acceptance of the work performed under the

[30] *See Lord's Landing Village Condo. Council of Unit Owners v. Continental Ins. Co.,* No. 98-1639, 1999 WL 710342 (4th Cir. Sept. 13, 1999); *Mut. Benefit Group v. Wise M. Bolt Co., Inc*., 227 F. Supp. 2d 469 (D. Md. 2002); *Harbor Court Assocs. v. Kiewit Constr. Co.,* 6 F. Supp. 2d 449 (D. Md.1998); *U.S. Fire Ins. Co. v. Milton Co.,* 35 F. Supp. 2d 83 (D. D.C. 1998); *Lerner Corp. v. Assur. Co. of Am.,* 120 Md. App. 525, 707 A.2d 906 (1998).

[31] 120 Md. App. 525, 707 A.2d 906 (1998).

contract was deemed to be final except as to latent defects. After the building was sold, the GSA discovered latent defects in the building's exterior façade. The insureds repaired the defects and sued their CGL carrier for coverage.

The Court held that there was no "occurrence" under the terms of the policy.[32] The Court explained that an accident occurs when a negligent act causes damage that is "unforeseen or unexpected" by the insured.[33] The Court reasoned that more than the mere assertion of a negligence claim is needed to allege an "accident," i.e., an event that is not within the insured's foresight or expectation.[34] The developer's obligation to repair the defects in the building was not unexpected or unforeseen because it was contemplated by the contract of sale.[35] The Court explained:

> If the damages suffered related to the satisfaction of the contractual bargain, it follows that they are not unforeseen. In other words . . . it should not be unexpected and unforeseen that, if the building delivered does not meet the contract requirements of the sale, the purchaser will be entitled to correction of the defect. This, we believe, would be the expectation and understanding of the reasonably prudent lay purchaser of a CGL policy.[36]

Hence, where an insured building contractor fails to fulfill his contract for financial reasons or because of poor workmanship, rather than reasons beyond his foresight and expectation, such an event may not be an accident. Note that *Lerner Corp.* may be limited in several ways. First, there was no claim asserted against the insureds for breach of contract. The insureds repaired their own defective work. Second, the defect in the façade did not cause any consequential damage to the work of third parties.

The reasoning in *Lerner Corp.* was extended in *Harbor Court Assocs. v. Kiewit Constr. Co.*[37] There, the owner and developer of the Harbor Court complex in

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[32] *Id.* at 537-38, 707 A.2d at 912.

[33] *Id.* at 536-37, 707 A.2d at 912.

[34] *Id.* at 536, 707 A.2d at 911.

[35] *Id.*, 707 A.2d at 912.

[36] *Id.* at 536-37, 707 A.2d at 912.

[37] 6 F. Supp. 2d 449 (D. Md. 1998). The Court analyzed an earlier policy which defined "occurrence" as "an accident or happening or event or a continuous or repeated exposure to conditions which results, during the policy period, in bodily injury or property damage neither *expected* nor intended from the standpoint of the insured." (emphasis added). Although the term "expected" was later included in a different section of the CGL policy, the

Baltimore's Inner Harbor area sued the general contractor and two subcontractors, alleging construction defects. The subcontractors, who were insureds under the same insurance policies, filed a third-party action against their insurers. The Court held that in the context of a construction project the word "expected" refers to damages for which an insured would be responsible in any event, irrespective of fault, because of its contractual obligations to properly construct its product.[38]

U.S. Fire Ins. Co. v. Milton Co.[39] involved a declaratory judgment action by the insurers of a developer and builder of the Bentley Place Condominium Project ("the Project") after an award for the plaintiffs in the underlying action. There, the Court denied the parties' cross-motions for summary judgment, reasoning that "there is no 'occurrence' under a comprehensive general liability insurance policy where a contractor's use of defective materials and substandard workmanship results in economic losses that would normally be recoverable in a breach of contract action."[40] The Court concluded that an award of damages in the underlying litigation for the replacement of inferior or omitted materials and the correction of substandard workmanship was not the result of an occurrence and noted that no consequential damages were awarded to compensate the unit owners for losses as a result of the use of inferior material and workmanship.[41] The Court noted that consequential damages that were not within the contemplation of the parties at the time of contracting (thus, typically not recoverable in a contract action) would be considered the result of an occurrence.[42] Other damages caused by a subcontractor's negligence, such as damage to roofing shingles and resulting water damage to the interior of the units, "may have been both unforeseeable (as a matter of contract law) and actually unforeseen (under the *Sheets* analysis)."[43]

In *Lord's Landing Village Condo. Council of Unit Owners v. Continental Ins. Co.,*[44] the Fourth Circuit extended this reasoning to bar coverage for defective work by an

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"expected or intended" exclusion, its meaning is intrinsic to the definition of "accident."

[38] *Id*. at 456-57.

[39] 35 F. Supp. 2d 83 (D. D.C. 1998) (applying Maryland law).

[40] *Id.* at 86.

[41] *Id*. at 87.

[42] *Id.*

[43] *Id.*

[44] No. 98-1639, 1999 WL 710342 (4th Cir. Sept. 13, 1999).

insured condominium developer's subcontractors. There, the condominium association sued the developer for faulty workmanship, including, among other issues, the failure to prime wood before painting, which caused the wood to rot. The Court reasoned that the breach of a duty to perform construction work properly was not an "accident" under the meaning of a CGL policy and, therefore, the insurer owed the developer no coverage.[45]

In *Mut. Benefit Group v. Wise M. Bolt Co., Inc.*,[46] an insurer sought a declaratory judgment that it had no obligation to defend or indemnify a contractor sued by homeowners alleging negligent construction and breach of contract. The U.S. District Court for the District of Maryland held that the insurer had a duty to defend, concluding that the homeowners had alleged property damage caused by an occurrence. Citing *Kiewit* and *Lerner Corp., supra*, the Court noted that in cases dealing with construction damage the "critical inquiry in determining whether alleged damages were 'expected' by the insured is whether the damages relate to the satisfaction of the insured's contractual obligations to construct its product or whether the damages relate to something other than the insured's product."[47] The Court noted that the homeowners had alleged in their complaint not only damage to the house built by the insured, but also damage to other property, including furnishings and food in their pantry, as well as loss of use of the house.[48] Damage to other property and loss of use damages did not fall within those damages for which an insurer would be liable, irrespective of fault, based upon its contractual duty to properly construct its product.[49] Therefore, because the complaint contained allegations potentially covered by the policy, the insurer had a duty to defend the contractor. [50]

In *French v. Assur. Co. of Am.*,[51] the Court considered whether a contractor's defective application of a synthetic stucco system was an accident and, thus, an occurrence. The Court noted that, under *Sheet*s, "an act of negligence constitutes an

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[45] 1999 WL 710342 at *3.

[46] 227 F. Supp. 2d 469 (D. Md. 2002).

[47] *Id*. at 475-76.

[48] *Id*.

[49] *Id*. at 476.

[50] *Id*. at 480.

[51] 448 F.3d 693 (4th Cir. 2006).

"accident" under a liability insurance policy when the resulting damage takes place without the insured's actual foresight or expectation."[52] It divided the property damage resulting from the defective stucco system into two categories: 1) the defective stucco system and 2) the damage to the non-defective structure and walls resulting from the intrusion of moisture through the defective stucco system.[53] As to the first category, the Court held that the Court of Special Appeals' decision in *Lerner, supra,* was determinative:

> With respect to the first category, *Lerner* unequivocally answers the question. We hold that just as the defective application of the building's stone façade did not constitute an "accident" and, therefore, not an "occurrence" under the materially similar CGL policies at issue in *Lerner*, so does the defective application of the EIFS exterior to the *Frenches'* home not constitute an "accident," and therefore, not an "occurrence" under the [policies]. . . . As the *Lerner* court reasoned: "[T]he obligation to repair the façade itself is not unexpected or unforeseen under the terms of the sales contract. Therefore, the repair or replacement damages represent economic loss and consequently would not trigger a duty to indemnify under a CGL policy.[54]

The Court observed, however, that *Lerner* did not provide an answer with respect to the second damages category because *Lerner* did not involve property damage to otherwise non-defective parts of the building.[55] It relied upon the reasoning set forth in a factually analogous case, *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*,[56] as well as upon *dicta* in *Lerner*.[57]

In *Am. Family*, the Court held that there was coverage under the 1986 CGL form to indemnify a general contractor for costs to remedy property damage to a warehouse, including sinking of the foundation and cracks in the structure, caused by settlement of the soil as a result of faulty site preparation advice from a soil engineering contractor.

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[52] *Id*. at 698.

[53] *Id*. at 703.

[54] *Id.*

[55] *Id*.

[56] 673 N.W. 2d 65 (Wis. 2004).

[57] 448 F.3d 703-04.

The Court held that the property damage to the warehouse was the result of an accident, i.e., the settlement of the soil, and therefore, was an "occurrence." The *French* Court observed that "the case before us appears to be on all fours with American Family."[58] It also observed that

> [a]t oral argument, counsel for Insurance Defendants candidly and correctly acknowledged that had a portion of the defective EIFS exterior on the *Frenches*' home fallen outwardly onto an automobile or inwardly onto a painting hanging on an interior wall or on furniture in the home, the 1986 ISO CGL Policies would have provided [the builder] liability coverage for damages to the automobile, the painting, and the furniture. In this same vein, it is illogical to contend that had the defective EIFS exterior on the *Frenches'* home failed and caused damage to the flooring inside the home or to the structural members of the house, neither of which was defective at completion of construction and certification for occupancy, coverage would not have been provided under the 1986 CGL Policies. This aspect of coverage is inherently different from coverage to correct the defective EIFS exterior on the *Frenches'* home.[59]

The *French* Court also noted that

> Maryland's Court of Special Appeals "makes the same point in *dicta* in *Lerner*. There, the court distinguished between the cost to correct a defect in work performed under a construction contract, for which no coverage under the 1986 ISO CGL policy form exists, and "property damage to something other than the defective object itself. . . ." *Lerner*, 707 A.2d at 912. "For example, if a collapse of the veneer had injured a user of the facility or damaged property other than the veneer itself, these may well be covered." *Id.* That is exactly the situation here.[60]

The Court concluded that the *Lerner dicta* "strongly suggests that, if faced with the facts before us in the present appeal, Maryland's highest court would find in favor of coverage for the costs to remedy the property damage to the otherwise nondefective structure and

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[58] *Id.* at 704.

[59] *Id.* at 705.

[60] *Id.*

walls of the *Frenches'* home."[61]

Recently, the Fourth Circuit, in an unreported opinion, *OneBeacon Ins. v. Metro Ready-Mix*,[62] considered whether, under Maryland law, the insured's provision of defective grout for a construction project involved an accident within the CGL's definition of "occurrence." In *Metro Ready-Mix*, the grout supplier argued that the defective grout "effectively damaged other property because the pile caps and columns that were placed on top of the grout were required to be removed."[63] The Court, however, rejected the argument, noting that there was no evidence that the pile caps and columns were damaged by the defective grout. Rather, any harm to those building components occurred as a result of replacing the defective material. This damage was not unforeseen. The Court observed,

> Just as a company will be presumed to foresee that it will be forced to pay for any defects in its own property, the company must also foresee that it will be forced to pay for incidental costs that are incurred in remedying those defects.[64]

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[61] *Id.* The Court also observed that its holding gave effect to the subcontractor exception to the "Your Work" exclusion in the policies. *Id.* It stated:

> As the Court of Appeals of Kansas expressly quoted with approval:
> "If the policy's exclusion for damage to the insured's work contains a proviso stating that the exclusion is inapplicable if the work was performed on the insured's behalf by a subcontractor, it would not be justifiable to deny coverage to the insured, based upon the absence of an occurrence, for damages owed because of property damage to the insured's work caused by the subcontractor's work. Reading the policy as a whole, it is clear that the intent of the policy was to cover the risk to the insured created by the insured's use of a subcontractor. Moreover, if coverage were never available for damage to the insured's work because of a contractor's mistake, on the theory that there was no occurrence even under those circumstances, the foregoing subcontractor proviso to the exclusion for damage to the insured's work would be meaningless, and if possible, policies should not be interpreted to render policy provisions meaningless. *Lee Builders, Inc. v. Farm Bur. Mut. Ins. Co,*. 33 Kan. App. 2d 504, 104 P.3d 997, 1003 (2005) (quoting *Windt, Insurance Claims and Disputes* §11.3, Supp. p. 48 (4th ed. 2001)).

[62] 2007 WL 2031613 (No. 06-1563, 4th Cir. July 13, 2007).

[63] *Id*.

[64] The Fourth Circuit relied primarily upon its reasoning in *French*, *supra*. It also noted that the Court of Special Appeals, in *Woodfin Equities Corp. v. Harford Mut. Ins. Co*., 110 Md. App. 616, 649, 678 A.2d 116, 132 n.8 (1996), *overruled in part on procedural grounds by Harford Mut. Ins. Co. v. Woodfin Equities Corp.*, 344 Md. 399, 687 A.2d 652 (1997), had held that property damage resulting from pulling up carpeting and breaking through drywall to access a defective HVAC system was not "property damage," but rather "cost incurred in replacing and repairing the [defective system]"). The District Court concluded that "[t]he caps and columns that had to be removed or destroyed to remedy the defective in Metro's product are on all fours with the carpeting and drywall that had to be

Two earlier cases decided by the U.S. District Court for the District of Maryland, *Reliance v. Mogavero*[65] and *I.A. Constr. Corp. v. T & T Surveying, Inc*.,[66] similarly held that the natural and probable consequences of poor workmanship do not constitute an "occurrence."[67]

In *Reliance Ins. Co. v. Mogavero*, [68] the insured general contractor's faulty workmanship had to be repaired or replaced. The allegedly defective work was limited to the work performed by the named insured. The Court stated broadly that the term "'occurrence'" [the 1973 ISO policy definition] does not include the normal, expected consequences of poor workmanship."[69] In *I.A. Constr. Corp. v. T & T Surveying*,[70] the insured surveyor's error caused another contractor to begin construction of a MARC train platform at Baltimore's Camden Yards station at the wrong elevation. Part of the platform had to be demolished and rebuilt. The Court held that there was no "accident" and hence no "occurrence," noting that "accident" means "an undesigned sudden and unexpected event" not the "natural and ordinary consequences of a negligent act."[71]

In *Sheets v. Brethren Mut. Ins. Co.*, [72] the Court of Appeals of Maryland specifically disapproved the analysis in *I.A. Constr. Corp. v. T & T Surveying, Inc.* to the extent that it adopted an objective test for "accident," but the Court did not comment on *Reliance Ins. Co. v. Mogavero*.[73]

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removed or destroyed in *Woodfin* to remedy the defect in the HVAC units." *Metro Ready-Mix*, 2007 WL 2031613 at *3.

[65] 640 F. Supp. 84 (D. Md. 1986).

[66] 822 F. Supp. 1213 (D. Md. 1993).

[67] *Reliance*, 640 F. Supp. at 86; *I.A. Constr. Corp.*, 822 F. Supp. at 1215.

[68] 640 F. Supp. 84 (D. Md. 1986).

[69] *Id*. at 86.

[70] 822 F. Supp. 1213 (D. Md. 1993).

[71] *Id.* at 1217.

[72] 342 Md. 634, 679 A.2d 540 (1996).

[73] The Court stated:

> At least one other case applying Maryland law has also relied on *Ed. Winkler & Son v. Ohio Cas. Ins.*, 51 Md. App. 190, 441 A.2d 1129 (1982), for the proposition

In *Mogavero*, there was no damage to property of anyone other than the insured; it simply performed its own work poorly. In *I.A. Constr. Corp.*, however, in dicta, the Court said that the poor surveying by the insured led to property damage to the work of another. Therefore, the narrow holding of *Mogavero* may still be valid.

The essence of the *Lerner Corp., French, Metro Ready-Mix, Harbor Court Assocs., Lord's Landing* and *U.S. Fire Ins.* decisions is that, regardless of the form of the cause of action, the insured's poor workmanship is never unforeseen from the insured's perspective.[74] A builder who constructs a defective structure knows that the owner/purchaser will suffer damages.[75] However, at least *French* and *Metro Ready-Mix* hold that damage to a building component other than the defectively built component is accidental. *Lerner Corp.*, the sole Maryland appellate court decision, is the least

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> that an "accident" is not "the natural and ordinary consequences of a negligent act" *Ed. Winkler*, 51 Md. App. at 195, 441 A.2d at 1132. *See I.A. Constr. Corp. v. T & T Surveying, Inc.*, 822 F. Supp. 1213, 1215 (D. Md. 1993) (holding that a surveying error is not an "occurrence" under Maryland law).

342 Md. at 550 n.4, 679 A.2d at 654 n.4.

[74] In *Harbor Court Assocs. v. Kiewit Const. Co.*, Judge Garbis reasoned:

> It is immaterial that the Consolidated Amended Complaint asserts claims against Kiewit-General, Smoot-Masonry, and Owen-Steel on theories of negligence and indemnification, in addition to breach of contract. The Lerner Court stated that "we hold that the damages claimed, *regardless of the form of the cause of action* that GSA might have maintained against the Insureds to repair the faulty construction of the facade, were not covered by the CGL policies issued to the Insureds and that the Insurers were not obligated to indemnify the Insureds for the costs incurred related to the repair of the building's damaged facade." *Lerner*, 707 A.2d at 909 (emphasis added). While the issue is not presently before the Court, this Court has previously held that when the relationship between parties is purely contractual and the heart of a plaintiff's complaint is that a defendant did not adequately perform its contract with plaintiff, no tort duties independent of the contractual duties between the parties arise. *Martin Marietta Corp. v. INTELSAT*, 763 F. Supp. 1327,1331-32 (D. Md.1991), *aff'd in part and rev'd in part*, 991 F.2d 94 (4th Cir. 1992).

6 F. Supp. 2d at 456 n.16.

[75] This is not the universal view. *See, e.g.*, Neeson and Meyer, *The Comprehensive General Liability Policy and its Business Risk Exclusions: An Overview*, Reference Handbook on the Comprehensive General Liability Policy (TIPS 1995) at 83-88; *see generally* 4 P. L. Bruner & P. J. O'Connor, *Construction Law* §11:37 (2003) ("Exclusions Affecting Coverage for Defective Work: Concept of 'Business Risk'").

expansive in its holding. Moreover, the Court of Appeals has not yet spoken. The Court of Appeals may give a broader interpretation to *Sheets* and construe coverage more broadly than *Lerner Corp.* and the federal courts have done. The Court may simply rule that there is no "occurrence" when the resulting property damage was subjectively intended or "substantially certain" to occur from the insured's perspective.

Applying the *Sheets* test to construction defects should result in a finding of an occurrence whenever the defects were not subjectively foreseeable by the insured; that is, the defects were not substantially certain to occur.

It is fair to say, however, that generally courts will not consider it an "accident" when a builder does not fulfill its contract. Even those courts which do not follow the broad line of reasoning that a breach of contract is not an occurrence may still conclude that a builder's defective work does not constitute an "occurrence." In such cases, the analysis should be whether the resulting property damage was subjectively intended or "substantially certain" to occur from the insured's perspective. If so, there was no "accident" because the property damage was "expected and intended."

3. Preventive Measures -- No Anticipatory Accidents

Preventive measures taken by the insured to avert an "occurrence" are not covered under the CGL policy. In *W.M. Schlosser v. INA*[76] a general contractor backfilled an excavation site when he was faced with the imminent collapse of the site. But for this emergency measure, adjacent structures owned by others might have been damaged. The general contractor looked to his liability insurer to cover his costs of backfilling and re-excavating the site. The Court noted that "no claims were made by others as a result of any personal injury or property damage."[77] Thus, there was no "occurrence" within the meaning of the policy.[78] Hence, measures taken to prevent imminent property damage or bodily injury as a result of a *threatened* accident do not constitute an occurrence unless and until the accident actually takes place.[79]

The Court of Special Appeals reached a seemingly discordant result in *Aetna Ins. Co. v. Aaron*,[80] holding that the liability portion of a homeowner's policy applied to the cost of

[76] 325 Md. 301, 600 A.2d 836 (1992).

[77] *Id*. at 306, 600 A.2d at 838.

[78] *Id.* at 306-07, 600 A.2d at 838-39.

[79] *Id. See also Bausch & Lomb, Inc. v. Utica Mut. Ins. Co.*, 330 Md. 758, 625 A.2d 1021 (1993).

[80] 112 Md. App. 472, 685 A.2d 858 (1996).

preventive measures undertaken on the insured's property to avoid damage to the property of a third party.[81] It held that remediation expenses reflecting the cost of repairing damage to the insured's property which were unrelated to the covered preventive measures were not covered.[82]

B. DEFINITION OF BODILY INJURY

The CGL is triggered only when someone has sustained bodily injury or property damage.

The 1973 ISO policy defined "bodily injury" as:

> bodily injury, sickness or disease sustained by any person which occurs during the policy period, including death at any time resulting therefrom.

The 1986 ISO policy defined "bodily injury" as:

> bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

The 1986 ISO policy was not intended to effect any significant change in the definition of "bodily injury."

Whether the plaintiff has sustained a "bodily injury" is readily apparent in most cases. A burn or scar is visible to the eye. A strained back or fractured vertebrae may be diagnosed by a physician. Some injuries, however, are not so clearly "bodily injuries." For example, what about a claim for pain, suffering, and mental anguish unaccompanied by physical injury? The Court of Special Appeals of Maryland held that such incorporeal injuries were "bodily injuries."[83] This holding seems to go against the national trend and may be subject to attack.[84] Loss of consortium, on the other hand, is not a separate bodily

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[81] *Id*. at 485, 685 A.2d at 864-65.

[82] *Id*.

[83] *See Loewenthal v. Security Ins. Co.*, 50 Md. App. 112, 123, 436 A.2d 493, 499 (1981).

[84] *See, e.g., Travelers Indem. Co. of Rhode Island v. Holloway*, 17 F.3d 113 (5th Cir. 1994) (in an action arising out of the insured's plot to kill the mother of a child who was competing against the insured's daughter for a junior high school cheerleading position, the insured had no coverage because injury resulting from intentional infliction of emotional distress was not "bodily injury"). In California, emotional distress arising out of a contractual relationship is not

injury, and hence, does not result in a separate occurrence within the meaning of the policy.[85]

Further, the complaint must seek damages "because of bodily injury."[86] In *N. Ins. Co. of N.Y. v. Baltimore Business Communications, Inc.*,[87] an insurer sought a declaratory judgment that it was not obligated to provide coverage to the insured, a defendant in a products liability class action in which the plaintiffs sought damages associated with the use of cellular telephones which allegedly emitted radiation, thereby exposing users to injuries. The complaint alleged that plaintiffs suffered biological effects of radio frequency radiation and the increased health risks arising therefrom as a result of their use of wireless handheld portable telephones sold and/or distributed by the

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"bodily injury" and does not trigger the duty to defend. *See Stein-Brief Group, Inc. v. Home Indem. Co.*, 76 Cal. Rptr. 2d 3 (Cal. App. 1998). *But see Am. States Ins. Co. v. Canyon Creek*, 786 F. Supp. 821 (N.D. Cal. 1991) (there was potential for coverage where claim of invasion of right of private occupancy arose from breach of contract); *Vandenberg v. The Superior Court of Sacramento County*, 982 P.2d 229 (Cal. 1999) (CGL policy that provides coverage for sums the insured is "legally obligated to pay as damages" does not necessarily preclude coverage for losses pleaded as contractual damages); *Ritchie v. Anchor Cas. Co.*, 286 P.2d 1000 (Cal. App. 1955) (insurer had duty to defend insured in lawsuit for breach of tort duty arising out of contract). In *Waller v. Truck Ins. Exchange, Inc.*, 900 P.2d 619 (Cal. 1995), the Supreme Court of California ruled that emotional distress claims arising from contractual relations or economic loss only were not covered under a CGL policy. The Court noted that the underlying lawsuit was a business dispute and the alleged torts were business and contract transgressions. The Court held that the acts complained of were, therefore, not occurrences. The Court stated:

> These [CGL] policies were never intended to cover emotional distress damages that flow from an uncovered "occurrence," and the parties could not reasonably have expected that coverage would be expanded merely because a claim of emotional or physical distress is alleged as a result of the economic loss. . . . All allegations in the [shareholder's] complaint were related to [his] asserted economic loss as a . . . shareholder, and . . . shareholder disputes are not covered by [the] policy."

900 P.2d at 630. *See generally* J. Brady and S. Danskin, *Emotional Distress: Minor Issue Muddies The Duty To Defend*, 57 Def. Couns. J. 208 (1990).

[85] *See, e.g., Valliere v. Allstate Ins. Co.*, 324 Md. 139, 143, 596 A.2d 636, 638 (1991); *Daley v. U.S.A.A.*, 312 Md. 550, 553-60, 541 A.2d 632, 633-36 (1988); *Travelers Indem. Co. v. Cornelsen*, 272 Md. 48, 51, 321 A.2d 149, 150 (1974). Similarly, loss of services is not a separate bodily injury. *Nationwide Mut. v. Scherr*, 101 Md. App. 690, 647 A.2d 1297 (1994).

[86] *Nationwide Mut. v. Scherr*, 101 Md. App. 690, 647 A.2d 1297 (1994). In *Reames v. State Farm Fire and Cas. Ins. Co.*, 111 Md. App. 546, 683 A.2d 179 (1996), the tort complaint contained a number of counts, none of which specifically alleged damages as a result of "bodily injury." The insured sought coverage claiming that the events giving rise to the complaint resulted in "bodily injury" and there were some factual allegations from which "bodily injury" could be inferred in the complaint. The Court held that unasserted claims of "bodily injury" do not trigger coverage. *Id*. at 560-61, 683 A.2d at 186. Even where there is extrinsic evidence and factual allegations in the complaint, there is no duty to defend unless the complaint alleges a claim for "bodily injury." *Id*. at 562-63, 683 A.2d at 187.

[87] 68 Fed. Appx. 414, 2003 WL 21404703 (4th Cir. June 19, 2003).

insureds.[88] The relief sought by the plaintiffs, however, was "compensatory damages including but not limited to amounts necessary to purchase a [cell phone] headset . . . for each class member."[89] The insurer contended that the plaintiffs did not seek damages for bodily injuries, but rather, the cost of the headsets to ensure that they would not be injured.[90]

The Court disagreed, noting that "in alleging that persons using cell phones without headsets suffer from the radiation emitted by such phones, the complaint alleges a 'bodily injury.'"[91] It concluded that the allegations of the complaint were sufficient to claim "damages because of" bodily injury.[92] It noted that on the face of the complaint, the plaintiffs were seeking "unspecified compensatory damages flowing from their bodily injuries," i.e., harm suffered from radiation.[93] Thus, the insured could potentially be liable to plaintiffs for "any and all compensatory damages recoverable under Maryland law, including damages for already existing bodily injuries.[94] The Court concluded, therefore, that unless admissible extrinsic evidence negated the allegations in the complaint, the insurer owed a duty of defense to the insured.[95]

Whether "bodily injury" has occurred has been a particular problem in latent disease cases and is discussed in the "Trigger of Coverage" section, *infra*.

C. DEFINITION OF PROPERTY DAMAGE

The 1973 ISO policy defined "property damage" to mean:

> (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time

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[88] *Id*. at 419, 2003 WL 21504703 at *1.

[89] *Id*. at 419, 2003 WL 21504703 at *3.

[90] *Id*. at 419-20, 2003 WL 21504703 at *4.

[91] *Id*.

[92] *Id*.

[93] *Id*. at 420, 2003 WL 21404703 at *4.

[94] *Id*.

[95] *Id*.

resulting therefrom, or

(2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

The 1986 ISO policy defined "property damage" as:

a. Physical injury to tangible property, including all resulting loss of use of that property; or

b. Loss of use of tangible property that is not physically injured.[96]

The 2001 ISO policy adds a limitation:

For the purposes of this insurance, electronic data is not tangible property. As used in this definition, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.

The definitions are substantially the same. The "property damage" must be damage to property of another.[97] The damage may not be to the insured's own property or the insured's own product.[98]

Both the 1973 and 1986/2001definitions are two-pronged and require either (1) physical injury to tangible property or (2) loss of use. Actually, there can be three types of property damage: pure physical injury property damage, loss of use as a result of physical injury to property, and loss of use without physical injury. Economic loss, i.e., loss of money alone, is not "property damage."[99] Each type of property damage has presented its

[96]One technical change from the 1973 policy to the 1986 policy is that the temporal requirement that injury or loss of use occur during the policy period was moved from the definition of "property damage" to the insuring agreement

[97] *Bausch & Lomb, Inc. v. Utica Mut. Ins. Co.*, 330 Md. 758, 783-88, 625 A.2d 1021, 1033-36 (1993).

[98] *Id.; Woodfin v. Harford Mut.*, 110 Md. App. 616, 649-50, 678 A.2d 116, 132 (1996), *rev'd on other grounds*, 344 Md. 399 (1997).

[99] *Travelers Indem. Co. of Am. v. Jim Coleman Automotive of Columbia, LLC*, 236 F. Supp. 2d 513 (D. Md. 2002) (the only injury found was money damages, which was not "property damage"). *See, e.g., Mack v. Nationwide Mut.*

own problems.

The history of the definition of "property damage" is illuminating. Prior to 1966, "property damage" was defined as "injury to or destruction of property." This definition was interpreted to include liability for intangible rights and obligations associated with property.[100] In *Hauenstein v. St. Paul-Mercury Indem. Co.,*[101] the insured used plaster in the construction of a hospital. The plaster shrank and cracked. The plaster distributor was sued for breach of warranty. Because the defective plaster diminished the value of the building the Court found "injury to or destruction of property."[102] This purely economic loss was not intended to be covered by the underwriters.

The ISO attempted to address this problem in the 1966 revision by adding the requirement that there be "injury to or destruction of *tangible* property"; however, this change did not do the trick. Courts continued to follow *Hauenstein*- type reasoning.[103]

Therefore, in 1973 the ISO once again redefined "property damage," this time to require "*physical* injury to or destruction of tangible property." Generally, physical injury to tangible property is thought of as:

> a harmful change in appearance, shape, composition, or some other physical dimension of the "injured" person or thing. If water leaks from a pipe and discolors a carpet or rots a beam, that is physical injury, perhaps beginning with the earliest sign of rot—the initial contamination (an important question

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Fire Ins. Co., 517 S.E.2d 839 (Ga. App. 1999) (borrower's loss of use of money as a result of insured lender's alleged usury in retail installment contracts was not "property damage"); *Shared-Interest Mgmt. Inc. v. Travelers Prop. Cas. Corp.*, 695 N.Y.S.2d 632 (App. Div. 1999) (breach of contract claims by which a property management company's client sought to recover damages from the company for economic loss alleging that the company's accounting manager had embezzled funds from the client were not claims for "property damage" as defined by the policy); *Old Republic Ins. Co. v. West Flagler Assocs. Ltd.*, 419 So. 2d 1174 (Fla. App. 1982) (where complaint alleges injury to investments and anticipated profits and the like, it does not allege facts within the coverage of liability policy covering damage to tangible property, and the insurer has no obligation to defend the suit).

[100] *See, e.g., Labberton v. Gen. Cas. Co.*, 332 P.2d 250 (Wash. 1958) (defective fertilizer applicator sprayed fields inadequately, reducing wheat yield); *Hauenstein v. St. Paul-Mercury Indem. Co.*, 65 N.W.2d 122 (Minn. 1954) (defective plaster diminished value of building).

[101] 65 N.W.2d 122 (Minn. 1954).

[102] 65 N.W.2d at 125-26.

[103] *See, e.g., U.S.F.& G. v. Nevada Cement Co.*, 561 P.2d 1335 (Nev. 1977) (defective cement used in construction of building resulted in injury to tangible property although loss was limited to installation of shoring and there was no collapse or removal of structure).

> in asbestos cases, as we shall see). The ticking time bomb, in contrast, does not injure the structure in which it is placed, in the sense of altering the structure in a harmful, or for that matter in any, way– until it explodes.[104]

The 1973 revision has been for the most part effective.[105]

In Maryland, poor workmanship may not constitute property damage.[106] In *Woodfin v. Hartford Mut.*,[107] the Court recognized that "[c]ourts uniformly hold that when property damage arising out of the insured's defective workmanship is confined to the insured's own work product, the damage is not caused by an "occurrence" within the meaning of the CGL policy." In *Woodfin*, the developers and general contractors of a hotel filed a declaratory judgment action against the CGL insurer of the HVAC subcontractor for damages allegedly resulting from the subcontractor's faulty installation of the HVAC system. The Court held that the cost of repair and replacement of the HVAC system and the cost associated with tearing out walls, molding, and carpeting in order to repair the HVAC system were not the result of an "occurrence."[108] On the other hand, the

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[104] *Eljer Manuf. Inc. v Liberty Mut. Ins. Co.*, 972 F. 2d 805, 808-09 (7th Cir. 1992) (dicta).

[105] *See, e.g., America Online, Inc. v. St. Paul Mercury Ins. Co.*, 347 F.3d 89 (4th Cir. 2003) (Va. law) (insurer had no duty under CGL policy covering actions for loss of tangible property to defend internet service provider against customers' claims that provider's software package caused physical damage to and loss of use of computer data, software and systems; computer data, software and systems were not tangible property); *Sting Sec. Inc. v. First Mercury Syndicate, Inc.*, 791 F. Supp. 555, 562 (D. Md. 1992) (Va. law) (damage to components of insured's security management system fell within exclusion for damage to insured's product and damages attributable to repair or replacement of the insured's product). *Cf. Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.*, 972 F.2d 805, 813 (7th Cir. 1992) (noting that the word "physical" in the definition of property damage serves an important limiting purpose, but holding that incorporation of defective product into another product inflicts physical injury at the moment of incorporation). *See generally* Laurie Vasichek, Note, *Liability Coverage For "Damages Because of Property Damage" Under the Comprehensive General Liability Policy*, 68 Minn. L. Rev. 795 (1984); John P. Arness and Randall D. Eliason, *Insurance Coverage for "Property Damage" in Asbestos and Other Toxic Tort Cases*, 72 Va. L. Rev. 943 (1986).

[106] Does the *Sheets* decision support this view? There, the Court held that "property damage" does not include the replacement of substandard materials and repair of inferior workmanship: "The Sheetses concede that the money spent to fix the [defective septic] system was economic loss and thus not covered under the policy as property damage." *Sheets*, 342 Md. at 645, 679 A.2d at 545. *See also Golden Eagle Ins. Co. v. Travelers Cos.*, 103 F.3d 750, 757 (9th Cir. 1996) (holding that an insured's faulty workmanship is not property damage). *See generally* A. D. Windt, *Insurance Claims and Disputes*, § 11:1 (4th ed. 2001). Windt comments that the *Golden Eagle Ins. Co*. holding "is unjustifiable," observing that "[i]f the insured's work physically deteriorates in some way, the work has suffered 'property damage.' Whether or not that damage is covered should depend upon whether the damage was caused by an occurrence and whether such damage is excluded from coverage.").

[107] 110 Md. App. 616, 648, 678 A.2d 116, 131 (1996), *rev'd on other grounds*, 344 Md. 399 (1997).

[108] *Id.* at 649, 678 A.2d at 131-32.

loss of use of the hotel suites, which were not the insured's work, was covered as "loss of use" type property damage.[109]

In *Reliance Ins. Co. v. Mogavero*, [110] the Court held that there was no coverage for claims against a general contractor whose faulty workmanship had to be repaired or replaced. The Court held that "property damage" had been defined to exclude defective work performed by the insured.[111] In contrast, the Court in *I.A. Constr. Corp. v. T&T Surveying*, [112] found covered "property damage" where a train platform had to be demolished and rebuilt after a surveyor's error caused another contractor to construct the platform at the wrong elevation. The Court did find, however, that no coverage existed for other reasons."[113]

The issue of whether defective work by an insured is "property damage" is a somewhat controversial one. The Court of Appeals of Maryland has not ruled on this issue. Some courts reason that faulty construction resulting in the creation of a building not in conformance with industry standards or the Building Code is not "property damage." This should be a fact-driven inquiry. The outcome should depend upon the nature of the defect, whose work is allegedly defective (the insured's or a subcontractor's), whether there was more than intangible economic loss and whether the damage was substantially certain to result.[114] Further, the outcome may depend upon whether property other than the defective thing itself has been damaged.[115] Finally, *W.M. Schlosser v. I.N.A.*[116] makes

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[109] *Id.* at 652-55, 678 A.2d at 133-34. *See also Johnson v Studyvin*, 839 F. Supp. 1490, 1496 (D. Kan. 1993) (additional living expenses while repairs were made on plaintiff's home were loss of use type property damage).

[110] 640 F. Supp. 84 (D. Md. 1986).

[111] *Mogavero*, 640 F. Supp. at 86. *See* discussion *infra* § III (2) (f).

[112] 822 F. Supp. 1213 (D. Md. 1993).

[113] *Id.* at 1215.

[114] *See, e.g., Eljer Mfg, Inc. v. Liberty Mut. Ins. Co.*, 972 F.2d 805 (7th Cir. 1992) (with regard to claim that defective plumbing system caused water damage and reduction in property value, court concluded that property damage occurred upon installation of defective system, even before leaking occurred); *W.E. O'Neil Constr. Co. v. Nat'l Union Fire Ins. Co.*, 721 F. Supp. 984 (N.D. Ill. 1989) (where insured's defective product had been integrated with someone else's property, damage to property as a whole constituted "property damage"); *Marathon Plastics, Inc. v. Int'l Ins. Co.*, 514 N.E.2d 479 (Ill. App. 1987) (pipe and gaskets sold by manufacturer, which leaked after they were incorporated into system, caused property damage due to diminution in value of water system).

[115] *See, e.g., French v. Assur. Co. of Am.*, 448 F.3d 693, 700 (4th Cir. 2006).

[116] 325 Md. 301, 306, 600 A.2d 836, 838 (1992).

clear that purely prophylactic measures to prevent property damage do not constitute property damage.

1. Tangible vs. Intangible Loss

The definition of "property damage" limits the scope of the policy to "physical injury to tangible property." Hence, economic losses or money damages are not recoverable as "property damage."[117] Further, the loss of a view is not physical injury to tangible property.[118]

An evolving issue concerns coverage for damage to data, particularly electronic data. Some courts have held that liability policies do not provide such coverage.[119] Some courts have found that they do provide coverage.[120] In a first-party context, a federal district court in Arizona ruled that loss of electronic data caused by a power outage constitutes

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[117] *See, e.g., Sting Sec. Inc. v. First Mercury Syndicate, Inc.*, 791 F. Supp. 555, 562 (D. Md. 1992) (Va. law) (lost profits, additional personnel costs, diminished capacity to generate new business and damage to business reputation are not "property damage"). *See also, e.g., Liberty Bank of Montana v. Travelers Indem. Co.*, 870 F.2d 1504, 1508-09 (9th Cir. 1989) (economic losses such as lost profits or good will are not considered property damage within the policy coverage); *Lassen Canyon Nursery v. Royal Ins. Co. of Am.*, 720 F.2d 1016 (9th Cir. 1983) (lost wages and benefits are not "property damage"); *North Atlantic Cas. & Sur. Ins. Co. v. William D.*, 743 F. Supp. 1361, 1365 (N.D. Cal. 1990) (same); *Liberty Mut. Ins. Co. v. Consolidated Milk Producers' Ass'n*, 354 F. Supp. 879 (D. N.H. 1973) (lost profits and good will are not property damage); *Mack v. Nationwide Mut. Fire Ins. Co.*, 517 S.E.2d 839 (Ga. App. 1999) (borrower's loss of use of money as a result of insured lender's alleged usury in retail installment contracts was not "property damage"); *Old Republic Ins. Co. v. West Flagler Assocs. Ltd.*, 419 So. 2d 1174 (Fla. App. 1982) (where complaint alleges injury to investments and anticipated profits and the like, it does not allege facts within the coverage of liability policy covering damage to tangible property, and the insurer has no obligation to defend the suit); *Hartford Acc. & Indem. Co. v. Case Found. Co.*, 294 N.E.2d 7 (Ill. App. 1973) (loss of investments, anticipated profits, and financial interests did not fall within "property damage"). *But see Shared-Interest Mgmt. Inc. v. Travelers Prop. Cas. Corp.* 695 N.Y.S.2d 632 (App. Div. 1999) (breach of contract claims by which a property management company's client sought to recover damages from the company for economic loss alleging that the company's accounting manager had embezzled funds from the client alleged "property damage" as defined by the policy). *See generally* 9 *Couch on Insurance 3d* §§ 126:35 and 126:36 (3d ed. 2003).

[118] *See Mitchell, Best & Visnic, Inc. v. Travelers Prop. Cas Corp.*, 121 F. Supp. 2d 848 (D. Md. 2000) (obstruction of view resulting from rebuilding necessitated by builder's negligent misrepresentations regarding restrictive covenants was not physical injury to tangible property).

[119] *See Magnetic Data, Inc. v. St. Paul Fire & Marine Ins.* Co., 442 N.W.2d 153 (Minn. 1989) (dicta) (insured's erasure of information stored on its customer's computer disk was not damage to "tangible property"); *Schaefer/Karpf v. CNA Ins. Co.*, 76 Cal. Rptr. 2d 42 (Cal. App. 1998) (incomplete erasure of videotape was not tangible property damage).

[120] *Centennial Ins. Co. v. Applied Health Care Sys., Inc.*, 710 F.2d 1288 (7th Cir. [Ill.] 1983) (Cal. law) (insurer had duty to defend where complaint alleged that insured's defective controllers caused loss of information stored in data processing system); *Retail Syst., Inc. v. CNA Ins. Cos.*, 469 N.W.2d 735 (Minn. App. 1991) (information contained on tape was "tangible property" within meaning of general liability policy providing coverage for physical injury to or destruction of tangible property).

"physical damage" to property.[121]

This issue will not arise under the 2001 revision of the CGL, which, unlike the earlier versions, specifically states that "electronic data is not tangible property."

The Fourth Circuit Court of Appeals considered whether damage to electronic data was property damage in *America Online, Inc. v. St. Paul Mercury Ins. Co*.,[122] which involved an earlier version of the CGL that did not address electronic data. In *America Online*, an internet service provider filed suit against its insurer, seeking coverage in connection with claims of customers that its proprietary software package caused damage to their computers, computer data, and software systems.[123] The insurer contended that the customers' claims did not allege damage to "tangible property," but rather interference with non-AOL software and loss of data and information, which the insurers contended were not tangible.[124] The insured argued that (1) because the plaintiffs alleged damage to computers, they alleged physical damage to tangible property; (2) because software involves the arrangement of atoms on computer disks, software has a physical property and thus damage to software is damage to tangible property; and (3) the term "tangible" is ambiguous and therefore should be construed in favor of the insured.[125]

The Court agreed with the insurer that the damages alleged by the plaintiffs did not constitute physical injury to tangible property. It observed that loss of or damage to software is not damage to computer hardware, because the physical aspects of the hard drive and the computer switches which receive information and instructions have not been damaged but simply reconfigured.[126] What have been damaged are the instructions, data and information provided by the programmer or user. These items are abstract and intangible. Therefore, because the underlying complaints did not allege physical injury to tangible property, the insurer had no duty to defend the insured.[127] The loss of use of the computers themselves would have been property damage except that it was excluded by

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[121] *Am. Guar. & Liab. Ins. Co. v. Ingram Micro Inc.*, No. 99-185 TUC ACM, 2000 WL 726789 (D. Ariz. 2000).

[122] 347 F.3d 89 (4th Cir. 2003) (Va. law).

[123] *Id*. at 91-92.

[124] *Id*. at 93.

[125] *Id*.

[126] *Id*. at 95-96.

[127] *Id*. at 98-99.

the "impaired property" exclusion, discussed *infra*.

D. WHEN DOES "BODILY INJURY" OR "PROPERTY DAMAGE" TAKE PLACE?

The "trigger" of coverage refers to the event or events which "must happen during the policy period in order for the policy to apply to the claim."[128] Both the 1973 and 1986 policies require that the "bodily injury" or "property damage" take place during the policy period. However, the "occurrence" which causes the injury or damage need not take place during the policy period. In most cases, such as those involving a "slip and fall" or a fire, the "occurrence" and the harm happen simultaneously, making the application of the policy simple. In other cases, such as those involving diseases caused by the inhalation of asbestos fibers, the negligent act occurs in one policy period and the injury occurs later, in another policy period. Which policy must respond? Two areas in which this issue is frequently litigated are claims involving (1) long-term exposure to harmful substances, such as asbestos, DES, or lead paint; and (2) progressive property damage.

1. The Occurrence Policy Trigger

The courts have developed a number of theories related to "trigger of coverage" (or date of occurrence). The four most popular theories are the exposure theory, the manifestation theory, the continuous (or triple trigger) theory, and the "injury-in-fact" or "actual injury" theory. To date, Maryland appears to favor the injury-in-fact trigger.

The exposure theory, first adopted by the Sixth Circuit in *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc.*,[129] holds that coverage is triggered by exposure (e.g., ingestion, inhalation, etc.) to the toxin or drug. All policies in force during the period of exposure are triggered and therefore those insurers must respond.[130]

The "manifestation theory," first enunciated in *Eagle-Picher Indus., Inc. v. Liberty Mut. Ins. Co.*,[131] provides that coverage is triggered when the disease first manifests, i.e.,

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[128] *FC&S Bulletin, Public Liability,* at 1 (1986).

[129] 633 F.2d 1212 (6th Cir. 1980), *clarified and aff'd on rehearing,* 657 F.2d 814 (6th Cir.), *cert. denied,* 454 U.S. 1109 (1981).

[130] *Id*. at 1225.

[131] 682 F.2d 12 (1st Cir. 1982), *cert. denied,* 460 U.S. 1028 (1983).

the date on which the disease becomes "reasonably capable of medical diagnosis."[132]

The "triple trigger" or "continuous trigger" theory holds that every insurer who issued a policy from the time of initial exposure to the toxin or drug to the time the injury actually manifests itself must respond.[133]

The "injury-in-fact" theory mandates that the insurer on the risk when the injury "in fact" occurs is solely liable. This rule has been applied in DES cases,[134] asbestos-related disease cases,[135] and hazardous waste cases.[136] Under the injury-in-fact rule, a CGL policy will be triggered if the injury or damage is determined to have occurred within the policy period irrespective of when the claimant was initially exposed or when the injury eventually manifested itself.[137]

The injury-in-fact test does not attempt to answer the question of when "property damage" or "bodily injury" occurs; rather, it is merely a restatement of the question, refocusing the inquiry on the facts of the particular case.[138] It will usually require expert testimony to determine when the "bodily injury, sickness or disease" or "property damage" took place. Injury-in-fact analysis may result in an exposure, a manifestation, or a continuous trigger result.[139]

While these four tests provide a convenient shorthand way to view the issue, the application of each theory differs from state to state.[140]

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[132] *Id.* at 25.

[133] *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982).

[134] *Am. Home Prods. Corp. v. Liberty Ins. Co.*, 565 F. Supp. 1485 (S.D. N.Y. 1983), *aff'd as modified*, 748 F.2d 760 (2d Cir. 1984); *Aetna Cas. & Sur. Co. v. Abbott Labs, Inc.*, 636 F. Supp. 546 (D. Conn. 1986).

[135] *Abex Corp. v. Maryland Cas. Co.*, 790 F.2d 119 (D.C. Cir. 1986).

[136] *Industrial Steel Container Co. v. Fireman's Fund Ins.*, 399 N.W.2d 156 (Minn. App. 1987). *See* James E. Scheuermann, *The Injury In Fact Theory as a Solution to the Trigger of Coverage Issue*, 24 Tort & Ins. Law J. 763 (1989).

[137] *See American Home Products Corp. v. Liberty Mut. Ins. Co.*, 748 F.2d 760 (2d Cir. 1984).

[138] One consequence of the uncertainty as to when the injury took place is that the insurer frequently will be called upon to defend. *See, e.g., Harbor Court Assocs. v. Kiewit Constr. Co.*, 6 F. Supp. 2d 449, 455 (D. Md. 1998).

[139] *See, e.g., Spartan Petroleum Co. v. Federated Mut. Ins. Co.*, 162 F.3d 805 (4th Cir. 1998) (S.C. law).

[140] For a discussion of the trigger of coverage issues, see Barry R. Ostrager and Thomas R. Newman, *Handbook on Insurance Coverage Disputes*, at § 7.05 (4th ed. 1991; Lee H. Ogburn, *The Progression of Trigger Litigation in*

a. Maryland Law

The Maryland law seems to follow a version of the injury-in-fact rule. However, the adoption of this rule came along a tortuous path.

The first "trigger of coverage" case purporting to apply Maryland law was *Mraz v. Canadian Universal Ins. Co., Ltd.*,[141] a case involving buried hazardous waste. In *Mraz*, the Fourth Circuit Court of Appeals applied a manifestation trigger. There, the policy term was from January 1, 1969 to January 1, 1970.[142] In August 1969, 1,300 barrels containing chemical waste were removed from the insured's plant site to a clay-lined pit.[143] The complaint alleged that preliminary investigation by the State of Maryland and the EPA in late 1981 and early 1982 established that hazardous substances had been released.[144] The release was discovered more than eleven years after the insurer went off the risk.[145] The insurance policy contained a "property damage" definition from the 1966 ISO policy which included the phrase "injury to or destruction of tangible property."[146] Note that the definition contains no requirement of "physical" injury.

The *Mraz* Court reasoned that because in such cases "the existence or scope of damage remains concealed or uncertain for a period of time even though damage is occurring . . . the better rule is that the occurrence is deemed to take place when the injuries first manifest themselves."[147]

A manifestation rule was first applied by the Court of Special Appeals of Maryland in *Harford Mut. Ins. v. Jacobson*,[148] a lead paint poisoning case. In *Jacobson*, the Court

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Maryland—Determining the Appropriate Trigger of Coverage, its Limitations, and Ramifications, 53 Md. L. Rev. 220 (1994).

[141] 804 F.2d 1325 (4th Cir. 1986).

[142] *Id*. at 1326.

[143] *Id*.

[144] *Id*.

[145] *Id.*

[146] *Id*. at 1327.

[147] *Id.* at 1328.

[148] 73 Md. App. 670, 536 A.2d 120 (1988).

held that coverage for a lead paint bodily injury case was triggered by the discovery of the harm, which the Court equated with manifestation.[149] There, the bodily injury manifested itself prior to the policy term. In *Mraz*, the "property damage" manifested itself after the policy term. Neither the *Mraz* Court nor the *Jacobson* Court found that the policy was triggered. Those decisions, however, have been undermined, if not overruled, by *Lloyd E. Mitchell v. Maryland Cas.*,[150] *Harford County v. Harford Mut. Ins. Co.*,[151] and *Chantel Assocs. v. Mount Vernon*.[152]

In *Lloyd E. Mitchell v. Maryland Cas.*, the Court of Appeals of Maryland appeared to adopt the exposure theory, and perhaps a double trigger (exposure and manifestation) theory, in asbestos-related disease bodily injury cases. There, Maryland Casualty had issued a CGL policy to Lloyd E. Mitchell, Inc. ("Mitchell"), a contractor who sold, distributed, and installed products containing asbestos.[153] The first policy was issued in 1955 and the last policy expired no later than January 1, 1978.[154] Mitchell was sued by plaintiffs seeking damages for injuries caused by exposure to its asbestos containing products.[155] The plaintiffs' exposure occurred during a policy period; however, discovery of the disease occurred after the expiration of the policies.[156] The Court reviewed the medical evidence and observed that there was no disagreement among the experts that inhalation and retention of asbestos fibers may cause immediate harm to the tissues of the lung.[157] It noted that because the definition of bodily injury includes "bodily injury, sickness, or disease" it is not necessary that the sickness or disease occur during the policy period if there is "bodily injury" even on a microscopic level.[158] The Court cited *Zurich*

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[149] *Id.*, 536 A.2d at 127.

[150] 324 Md. 44, 595 A.2d 469 (1991).

[151] 327 Md. 418, 610 A.2d 286 (1992).

[152] 338 Md. 131, 656 A.2d 779 (1995).

[153] *Mitchell*, 324 Md. at 46, 595 A.2d at 470.

[154] *Id*.

[155] *Id*. at 47, 595 A.2d at 470.

[156] *Id*. at 48, 595 A.2d at 471.

[157] *Id.* at 61-62, 595 A.2d at 477-78.

[158] *Id*. at 57-62, 595 A.2d at 475-78.

Ins. Co. v. Northbrook Excess and Surplus Ins. Co.,[159] in which the Illinois intermediate appellate court held that "bodily injury" means "harm or damage of or relating to the body" and *INA v. Forty-Eight Insulations*, [160] which held that "for insurance purposes, courts have long defined the term 'bodily injury' [to mean] any localized abnormal condition of the living body."[161] The Court concluded that "manifestation" is not the sole trigger of coverage. At a minimum, coverage is triggered by exposure to the insured's asbestos-containing products during the policy period by a person who suffers bodily injury as a result of that exposure.[162]

In *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Porter Hayden Co.*, Judge Davis of the United States District Court for the District of Maryland held that asbestosis created a continuous trigger.[163]

In *Lloyd E. Mitchell, supra,* the Court held that exposure triggered coverage where the diseases were caused by asbestos-containing products. Does the same rule apply to lead paint poisoning cases? Judge Motz, the author of the *Mraz* opinion at the trial level, held in a lead paint poisoning case that:

> [A]lthough the Court of Appeals has not specifically addressed the "trigger" question in the lead poisoning context, it is clear to me that the transition from *Mraz* to *Harford County* demonstrates that exposure plus bodily injury (even if unmanifested) is now sufficient under Maryland law to trigger coverage.[164]

Thus, the Court held that a policy may be triggered even where the child is not yet sick if there is proof of exposure and if the medical experts testify that there was bodily injury (even on a microscopic level) during the policy term.[165]

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[159] 494 N.E.2d 634, 642 (Ill. App. 1986).

[160] 633 F.2d 1212 (6th Cir. 1980).

[161] *Id.* at 1222.

[162] *Mitchell*, 324 Md. at 63, 595 A.2d at 478.

[163] 331 B.R. 652 (D. Md. 2005)

[164] *Scottsdale Ins. v. Am. Empire Surplus Lines*, 811 F. Supp. 210, 215 (D. Md. 1993). Judge Motz states in a footnote "although the Court has discreetly refrained from expressly saying that the Fourth Circuit misinterpreted Maryland law in *Mraz*, it has made clear that manifestation of injury is not the sole trigger of coverage. *Id*. at 215 n.2.

[165] *Id*. at 215.

This analysis turned out to be correct. The Court of Appeals of Maryland applied the injury-in-fact rule to a lead-based paint poisoning case in *Chantel Assocs. v. Mount Vernon Fire Ins. Co.*[166] There, the Court held that "bodily injury," as defined by the policy, occurs when the child is exposed to lead paint, lead chips and lead dust.[167] In *Chantel*, a psychologist swore in an unrebutted affidavit that exposure to lead paint causes bodily injury such as cell, tissue, or organ damage shortly after exposure. [168] Thus, in lead-based paint poisoning cases an injury-in-fact analysis has frequently resulted in an exposure trigger.[169] Moreover, exposure over multiple years will trigger multiple policies.[170]

The trigger of coverage in environmental property damage cases was governed by the *Mraz* manifestation rule until the Court of Appeals of Maryland decided *Harford County v. Harford Mut. Ins. Co*.[171] There, the Court addressed a single issue:

> Whether, in the context of alleged environmental property damage, the standard form comprehensive general liability insurance policies are "triggered" for the policy periods when the damages take place, as opposed to the policy period when the damages are discovered or "manifested."[172]

The Court concluded:

> [W]e hold that "manifestation" is not the *sole* trigger of coverage in environmental pollution cases. Rather, we conclude that coverage under the

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[166] 338 Md. 131, 656 A.2d 779 (1995).

[167] *Id*. at 144, 656 A.2d at 785-86.

[168] *Id*. at 144 n.8, 656 A.2d at 786 n.8.

[169] The result in *Chantel* appears open to attack, as the affidavit of the psychologist, a specialty without the medical training normally thought sufficient to make such an affidavit, was unopposed.

[170] *See United Serv. Ass'n v. Riley*, 393 Md. 55, 899 A.2d 819 (2006) (where exposure to lead, and resulting bodily injury, spanned more than one policy period, insurer's limit of liability provision did not limiting liability coverage to a single per occurrence limit; each separate policy was implicated by a "continuing occurrence"); *Md. Cas. Co. v. Hanson*, 169 Md. App. 484, 902 A.2d 152 (2006) (continuous injury trigger applied where child had repeated exposure to lead spanning multiple policy periods; insurer's liability was thus not limited to a single policy's limits).

[171] 327 Md. 418, 610 A.2d 286 (1992).

[172] *Id.* at 420, 610 A.2d at 287.

> policies may be triggered during the policy period at a time earlier than the discovery or manifestation of the damage.[173]

Thus, the insured may prove that property damage occurred within any policy term prior to manifestation. The Court suggested:

> Whether at any time during the policy period the discharge of contaminants into the soil and underlying ground water is of sufficient gravity to prove detectable "property damage" within the policies' definition of that term is quite likely a matter of expert testimony.[174]

Therefore, the insured is not restricted to the policy period during which the property damage is discovered or "manifested," but may prove that actual "detectable property damage" occurred during any period prior to manifestation. The decision leaves open the possibility that manifestation may be a default trigger.

In 2002, the Court of Special Appeals of Maryland adopted an injury-in-fact/continuous trigger theory for asbestos-containing property damage cases. In *Mayor and City Council v. Utica Mut. Ins. Co.*,[175] the Court held that the injury-in-fact/continuous trigger of coverage applied to long-term and continuing damage resulting from the installation and continued presence of asbestos in buildings. Thus, CGL policies taking effect after manifestation of the injury could provide coverage in connection with the liability of an installer of asbestos-containing building materials. In so holding, the Court observed that although the injury-in-fact trigger was "an appropriate trigger of coverage rule for asbestos-in-building property damages, this trigger does not preclude coverage under subsequent policies when there is continued exposure."[176] It further stated, "We reject trigger theories that are based exclusively on exposure to harm or the manifestation of injury."[177] The Court explained:

> Neither the initial exposure (in this case the installation of asbestos in the City's schools), nor the discovery (manifestation) of the injurious effects of

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[173] *Id.* at 435-36, 610 A.2d at 294-95 (emphasis added).

[174] *Id.* at 436, 610 A.2d at 295.

[175] 145 Md. App. 256, 802 A.2d 1070 (2002).

[176] *Id*. at 297, 802 A.2d at 1094.

[177] *Id.* at 302, 802 A.2d at 1098.

> the [asbestos-containing building materials], comports with the "occurrence" language of the CGL policies, which is predicated in part on "the continuous or repeated exposure to conditions" that is implicated by the continuing presence of asbestos in the City's buildings.[178]

The Court, therefore, concluded,

> We are persuaded that the continued presence of asbestos-containing building materials constitutes "property damage" within the reach of the standard CGL policy. . . . Thus, we hold that the continuing "injury" persists beyond the point at which the injured party "discovered" or should have discovered, the harmful effects of the [asbestos-containing building materials].[179]

The Maryland appellate courts' rejection of manifestation as the sole trigger theory is consistent with the national trend. Manifestation has proven to be a difficult theory to apply.[180] While it may be convenient to refer to an injury-in-fact test, the test that the Maryland courts eventually adopt in bodily injury cases may differ significantly from the "injury-in-fact" test (or one of the other tests) as applied in other states. The recent appellate decisions concerning bodily injuries have applied an injury-in-fact/exposure test. However, because bodily injury is defined as "bodily injury, sickness or disease," it is easy to envision the courts finding in a latent disease case that one policy is triggered when the plaintiff suffers injury on a microscopic (cell or tissue) level, and a second policy is triggered when the plaintiff becomes sick. Thus, in such cases, an injury-in-fact rule may yield the same result as a continuous trigger rule.[181]

In short, the law is in transition and it is uncertain how the multiple issues raised by the injury-in-fact rule will be resolved by Maryland courts.

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[178] *Id*. at 303, 802 A.2d at 1098 (citations omitted).

[179] *Id*. at 304-05, 802 A.2d at 1099.

[180] *See generally* Robert D. Fram, *End Game: "Trigger of Coverage" in the Third Decade of CGL Latent Injury Litigation* (454 PLI Jan.-Feb. 1993); Carol Nakhuda Cohen, Case Note, Harford County, Maryland v. Harford Mutual Ins. Co.: *Trigger of Coverage in Environmental Property Damage Cases Not Limited To Discovery or Manifestation of Damage*, 3 U. Balt. J. Envtl. L. 119 (Winter 1993).

[181] *See Riley* and *Hanson, supra* n.170.

b. Known Losses and Losses in Progress

Some courts applying the continuous trigger or injury-in-fact test have concluded that "losses-in-progress" and "known losses" are covered.[182]

A leading out-of-state case on this point is *Montrose Chem. Corp. v. Admiral Ins. Co.*[183] In that case, the insured, Montrose, had manufactured DDT at its plant in California from 1947 through 1982.[184] Montrose was sued for damages resulting from its disposal of toxic waste at a number of sites in California. Admiral had issued comprehensive general liability policies to Montrose from 1982 until 1986.[185] Although six earlier insurers defended, Admiral denied coverage, contending that the losses did not occur during its policy period and that the actions were uninsurable losses-in-progress.[186] The California Court of Appeals held, however, that continuing injury occurring during the policy period after the injury-in-fact can first be pinpointed is subject to coverage.[187]

Similarly, in *Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co.*, [188] the Court found that the known loss doctrine[189] did not bar coverage for environmental damages

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[182] *See, e.g., Stonehenge Eng'g Corp. v. Empl. Ins. of Wausau*, 201 F.3d 296, 301-02 (4th Cir. 2001) (S.C. law) (known loss doctrine did not preclude coverage; at time CGL policy took effect, insured contractor did not know that it was legally liable for negligent construction or that such liability was substantially certain to occur); *Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co.*, 124 F.3d 508, 516 (3d Cir. 1997) (knowledge of loss, by itself, was insufficient to defeat coverage, where insured entered into contract of insurance before insured had legal obligation to pay damages to third party in connection with loss). *But see Rohm and Haas Co. v. Continental Cas. Co.*, 781 A.2d 1172 (Pa. 2001) (known loss doctrine provided insurer with a defense if, at the time they purchased excess liability insurance, insureds knew or should have been aware of a likely exposure to losses which would have reached the coverage of excess insurers). *See generally* 7 *Couch on Insurance 3d* §102:8 (3d ed. 2003).

[183] 913 P.2d 878 (Cal. 1995).

[184] *Id.* at 881.

[185] *Id.*

[186] *Id.* at 883-84.

[187] *Id.* at 895.

[188] 124 F.3d 508 (3d Cir. 1997).

[189] The Court defined the "known loss doctrine" as follows:

> The known loss doctrine is a common law concept that derives from the fundamental requirement of fortuity in insurance law. Essentially, the doctrine provides that one may not obtain insurance for a loss that either has already taken place or is in progress. *See generally* 12 John A. and Jean Appleman, *Insurance Law & Practice* § 7001 (rev. ed. 1981). As we have recognized, "the

occurring after an environmental study of the property found substantial oil contamination.

The decisions in *Montrose* and *Pittston Co. Ultramar Am. Ltd.* challenged the old axiom, "you can't buy insurance on a burning building." In response to these decisions, in 1999, the ISO added to the CGL a mandatory endorsement and provision that exclude damages for known injury.[190] The "known loss" endorsement and provision are intended to exclude losses of which the insured already has knowledge.

The "known loss" endorsement excludes "bodily injury" or "property damage" that an insured "knew had occurred, in whole or in part … prior to the policy period." Moreover, "any continuation, change or resumption of such 'bodily injury' or 'property damage' during or after the policy period will be deemed to have been known prior to the policy period."[191] This endorsement was incorporated into the insuring agreement of the 2001 edition of the CGL.

Who at the insured entity must have knowledge of the loss for it to be excluded as a known loss? The "known loss" provision specifies that the insured will be deemed to have knowledge possessed by any named insured or "employee[s] authorized by you to give or receive notice of any 'occurrence' or 'claim'" (i.e. the claims administrator). The loss is deemed "known" at the earliest of the following events. When the insured:

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rule is based on the realization that the purpose of insurance is to protect insureds against unknown risks." *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 63 (3d Cir. 1982) (citations omitted). State courts are divided as to the scope of the known loss doctrine. Some have construed it quite narrowly, barring coverage only when the insured knew of certainty of damages and liability. *See Montrose Chemical Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 42 Cal. Rptr.2d 324, 913 P.2d 878, 906 (Cal. 1995) (*en banc*) ("[A]s long as there remains uncertainty about damage or injury that may occur during the policy period and the imposition of liability . . . and no legal obligation to pay third party claims has been established, there is a potentially insurable risk ...."). Others have refused to find coverage when the insured was substantially aware of a risk of loss. *See Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 154 Ill.2d 90, 180 Ill. Dec. 691, 697, 607 N.E.2d 1204, 1210 (1992) ("If the insured knows or has reason to know, when it purchases a CGL policy, that there is a substantial probability that it will suffer or has already suffered a loss, the risk ceases to be contingent and becomes a probable or known loss.").

Id. at 516.

[190] *See* BO Policy No. CG 00 57.

[191] *Id*.

> (1) Reports all, or any part, of the "bodily injury" or "property damage" to us or any other insurer;
> (2) Receives a written or verbal demand or claim for damages because of the "bodily injury" or "property damage"; or
> (3) Becomes aware by any other means that "bodily injury" or "property damage" has occurred or has begun to occur.

The "known loss" provision also makes clear that injury which occurs during a prior policy period and continues into the present policy period is a "known loss."

The Fourth Circuit addressed the applicability of a similar provision in an unreported case, *Westport Ins. Corp. v. Albert*.[192] In *Albert*, the insurer sought a declaration that it did not have to provide coverage under either of two accounting malpractice policies for a claim made against the insured, a licensed attorney and professional accountant. The policies were successive, covering the periods January 1, 2001 to January 1, 2002 and January 1, 2002 to January 1, 2003, respectively.[193] Each policy promised to defend and indemnify the insured from any accounting malpractice claims made against and reported by him during the applicable policy period.[194] The 2002 policy excluded from coverage any "act, error, omission, circumstance, or 'personal injury' occurring prior to January 1, 2002, that the insured 'knew or could have reasonably foreseen," even if the claim against the insured was made during the policy period.[195]

In 2001, a dispute arose out of the insured's management of an estate, and a beneficiary filed a petition to remove him as personal representative of the estate. In the petition, the beneficiary alleged, *inter alia*, that the insured breached his fiduciary duty, failed to account for the estate's assets, and provided intentionally inaccurate accountings.[196] On January 30, 2002, the beneficiary filed a complaint in the Superior Court of the District of Columbia, claiming accounting and legal malpractice. The insured provided the insurer with notice of the suit on February 19, 2002.[197]

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[192] 208 Fed. Appx. 222, 2006 WL 3522500 (No. 05-1726, 4th Cir. Dec. 6, 2006).

[193] *Id*. at 224, 2006 WL 3522500 at *1.

[194] *Id*.

[195] *Id*.

[196] *Id.*

[197] *Id*., 2006 WL 3522500 at *1-2.

The insurer contended that the prior knowledge exclusion barred coverage under the 2002 policy because the allegations in the removal petition "would have put any reasonable accountant on notice that a malpractice suit was forthcoming."[198] The Court agreed, stating that "[a]ccusations of that sort should have put a reasonable accountant on notice that [the beneficiary] could next file a claim for damages." [199] The Court affirmed summary judgment in favor of the insurer. The Court also rejected the insured's argument that he should have been permitted to amend his answer and counterclaim to retract the admission that he had knowledge of the claim prior to 2002. The Court noted that the requested amendment would have been futile, because an "objectively reasonable" insured would have foreseen the malpractice claim.[200] Thus, the exclusion would apply even if the amendment were allowed.[201]

In *Maryland Cas. Co. v. Hanson*,[202] the Court of Special Appeals considered the application of the "known loss" doctrine in a lead paint exposure case. There, the insurer argued that the doctrine precluded coverage because the insured was allegedly aware of the plaintiffs' lead poisoning before the effective date of the policy.[203] The court, however, concluded that the doctrine was not determinative, reasoning that the known loss defense was "closely linked" to the manifestation trigger theory.[204] Because the continuous trigger, not the manifestation trigger, was applicable to lead paint cases, the known loss doctrine was inapplicable.[205] Moreover, because the plaintiffs intended to seek damages for separate injuries occurring during each successive policy period, in order to preclude coverage under the doctrine, the insureds' purported knowledge would have to be shown for each specific injury, further highlighting its inapplicability.[206]

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[198] *Id*. at 225, 2006 WL 3522500 at *2.

[199] *Id*. at 226, 2006 WL 3522500 at *3.

[200] *Id.*, 2006 WL 3522500 at *4.

[201] *Id*.

[202] 169 Md. App. 484, 902 A.2d 152 (2006).

[203] *Id*. at 522, 902 A.2d at 174.

[204] *Id.*

[205] *Id.*

[206] *Id*.

c. Allocation

There are three methods used to allocate liability in cases of ongoing injury when more than one policy period is triggered: the "joint and several" or "all sums" theory, the "actual injury" theory and the "pro rata" theory. The Court of Special Appeals of Maryland has adopted a "pro rata by time on the risk" rule along with a "horizontal exhaustion" theory.

i. The Joint and Several Approach

The "joint and several" theory was first enunciated in *Keene Corp. v. Ins. Co. of N. Am.*[207] The "joint and several" allocation method makes each insurer on the risk during any portion of a long-term bodily injury claim responsible for the full amount of the loss. The portion of the loss which took place during a particular policy period is not an issue. In *Keene Corp*., Judge Bazelon based his analysis on the principle of maximizing coverage. Other courts following this theory accept the argument that the language of the insuring agreement in the CGL dictates that each insurer on the risk during the relevant period of exposure may be responsible for the entire loss.[208] Insureds point to the following language in the CGL to support this position:

> We will pay *those sums* that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage…." (emphasis added).

Insureds argue that the phrase "those sums" includes all damages related to any injury, including all consequential or subsequent damages arising from the injury. For example, in an automobile accident case, an insurer often is responsible for paying damages for pain and suffering and other consequential damages that relate to a personal injury but arise later in time than the initial injury. Thus, each policy on the risk may be independently responsible for paying all damages that an insured becomes liable to pay.

Likewise, an insurer who is on the risk when an injury arises but not when the

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[207] 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007 (1982).

[208] "Although each policy is triggered only by the occurrence of an injury during the policy period, once a policy is triggered, the policy obligates the insurer to pay all sums which the insured becomes liable to pay as damages for bodily injury or property damage. The insurer is responsible for the full extent of the insured's liability (up to the policy limits), not just for the part of the damage that occurred during the policy period." *Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 26 Cal. Rptr. 2d 35, 59 (Cal. App. 1998).

occurrence took place must pay damages for such injury. For example, if a plaintiff was exposed to a noxious chemical thirty years ago, but the effects of such exposure do not manifest themselves until today, the insurer of the chemical manufacturer today must pay for any damages that result. Under the terms of the CGL, only the bodily injury or property damage must take place during the policy period; the occurrence can be at any point in time to trigger coverage, so long as it causes bodily injury or property damage during the policy period.[209] Further, the CGL defines "occurrence" to include "continuous or repeated exposure to conditions which result in bodily injury." The courts adhering to the joint and several approach maintain that this definition is evidence that insurers intended to provide coverage for the entire period of exposure.[210]

Applying the joint and several approach places the responsibility for uninsured periods on insurers as opposed to insureds. Each insurer is independently obligated to pay for the entire loss; thus, uninsured periods become a non-issue. The question remaining is how the insurers should divide up the uninsured portion of the loss among themselves.

The reasoning of the "joint and several" approach is suspect. First, the "all sums" approach ignores the limiting phrase "to which this insurance applies." The policy limits its coverage to "bodily injury" which occurs during the policy period. Second, this approach makes an insurer liable for losses which occurred outside its policy period. Third, it provides the insured with coverage for periods for which it did not pay a premium.

ii. The Actual Injury Approach

Under the "joint and several" approach, the requirement that the bodily injury take place during the policy period is relevant only to whether a policy is triggered. The "pro-rata" and "actual injury" cases hold that the CGL policy applies only to that portion of the injury or damage which occurs within the policy period. Under the "actual injury" analysis, the court determines the amount of the injury or damage which occurred during each policy period and apportions the liability among the triggered policies accordingly. [211]

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[209] The Court of Appeals of Maryland addressed the issue of when bodily injury occurs during the policy period in *Chantel, supra*. The *Chantel* Court applied an injury-in-fact analysis in a lead paint case, deciding that the injury in the lead paint context actually occurs at a cellular level at the time of exposure. 338 Md. at 144, 656 A.2d at 785-86.

[210] *See, e.g., J.H. France Refractories v. Allstate*, 626 A.2d 502, 508 (Pa. 1993).

[211] *See, e.g., Abex Corp. v. Md. Cas. Co.*, No. 82-1098, 1194 US Dist. Lexis 11908 (D. D.C. 1994); *Uniroyal, Inc. v. Home Ins. Co.*, 707 F. Supp. 1368 (E.D. N.Y. 1988); *Am. Home Prods. Corp. v. Liberty Mut. Ins. Co.*, 565 F. Supp. 1485 (S.D. N.Y. 1983).

Like the injury-in-fact trigger, the "actual injury" determination may be difficult and time consuming, may call for an in-depth medical or scientific inquiry, or may simply be impossible.

iii. The Pro Rata Approach

The pro rata, or proportionate share, approach allocates the loss evenly among each of the policy periods during which the "bodily injury" occurred.[212]

Scottsdale Ins. Co. v. Am. Surplus Lines Ins. Co.[213] was the first case applying Maryland law that addressed the allocation issue in this context.[214] In that case, three insurers were potentially liable for lead-based paint poisoning claims. Candace Anthony, the infant plaintiff, resided on Homestead Avenue in Baltimore City from her birth on January 17, 1983, through June 6, 1985.[215] GEICO insured the premises.[216] Candace then moved with her mother to 2534 Garrett Avenue, where they lived until July 1986.[217] For the first four months on Garrett Avenue, the property was insured with American Empire. For the remaining nine months, Scottsdale was on the risk.[218] Candace filed suit, alleging lead poisoning at both Homestead Avenue and Garrett Avenue. GEICO and Scottsdale settled for $190,000, with Scottsdale contributing $152,500 and GEICO contributing $37,500; American Empire refused to contribute.[219]

Judge Motz determined that American Empire was obligated to provide coverage, holding that additional exposure to, and injury from, lead-based paint during the policy period triggered coverage, even where the poisoning was discovered prior to the policy

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[212] *See, e.g., Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc*., 633 F.2d 1212, 1224-25 (6th Cir.), *reh'g granted*, 657 F.2d 814 (6th Cir. 1980); *Scottsdale Ins. v. Am. Surplus Lines Ins. Co.*, 811 F. Supp. 210 (D. Md. 1993).

[213] 811 F. Supp. 210 (D. Md. 1993).

[214] *See also Lafarge Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 935 F. Supp. 675 (D. Md. 1996) (Harvey, J.) (Texas law) (applying a pro-rata analysis).

[215] *Id*. at 211.

[216] *Id*.

[217] *Id*.

[218] *Id*.

[219] *Id*.

period.[220] With respect to allocation, Judge Motz concluded that it would be inequitable to require insurers to share a loss equally as a matter of law.[221] The Judge reasoned that it would be unfair to require an insurer who was on the risk for one day during the exposure period to pay the same amount as the insurer who was on the risk for two years during the exposure period.[222] Further, Judge Motz decided to prorate the uninsured portion of the loss to the insured.[223]

In 2002, the Court of Special Appeals of Maryland adopted the prorata/time on the risk approach to apportionment. In *Mayor and City Council of Baltimore v. Utica Mut. Ins. Co.*,[224] the Court of Special Appeals was asked to determine which of several insurance policies provided liability coverage in connection with claims against an installer of asbestos-containing insulation in Baltimore city buildings, and to what extent and in which sequence such coverage would apply.

The Court held that in cases involving continuing asbestos product property damage:

> (1) the obligation to indemnify the insured . . . is to be prorated among all carriers based upon their time on the risk;
>
> (2) the "joint and several" or "all sums" allocation method is incompatible with the injury-in-fact/continuing trigger [which the Court has held was applicable in such cases];
>
> (3) an insured who elects not to carry liability insurance for a period of time, either by electing to be self-insured, or by purchasing a policy which withholds coverage pursuant to a particular exclusion . . . will be liable for the prorated share that corresponds to periods of self-insurance or no coverage, and

[220] *Id.* at 215.

[221] *Id.* at 217.

[222] *Id.*

[223] *Id.*

[224] 145 Md. App. 256, 802 A.2d 1070 (2002).

(4) the concept of 'horizontal exhaustion' is applicable."[225]

The Court explained that it chose the "pro rata/ time on the risk" method of allocation "because it conforms with the realities of long-term property damage resulting from asbestos in buildings, and the application of the injury-in-fact/continuous trigger of coverage."[226] It rejected the "all sums" approach, that each policy provides full indemnification for all liability resulting from an occurrence, and the "joint and several" approach, under which the insured may choose which insurer would be required to respond to the full liability, noting its agreement with other courts that such an interpretation could not reasonably have been expected by the insured when it purchased the policies.[227]

With regard to the exhaustion issue, i.e., the order in which the policies would be called upon to provide coverage, the Court held that the "horizontal exhaustion" rule, which provides that the insured must exhaust all primary insurance before excess insurance coverage will come into play, "is the best fit for the realities of [asbestos long-term property damage] cases."[228] Again, the Court noted that horizontal exhaustion was consistent with the application of the continuous trigger and pro-rata allocation.[229] Within that context, each excess carrier would look to whether the underlying policy's coverage was exhausted before responding to a request for indemnification.[230]

Shortly after the Court of Special Appeals' opinion in *Mayor and City Council, supra*, the U.S. District Court for the District of Maryland applied the pro rata/ time-on-the-risk theory in a case involving asbestos-related personal injuries. In *Aetna Cas. and Sur. Co. v. The Wallace & Gale Co.*,[231] workers claiming asbestos-related bodily injuries intervened in a case against a bankrupt insulation contractor. The Court granted an insurer's motion for reconsideration of its prior order adopting an "all sums" approach to allocation, in light of the subsequent holding in *Mayor and City Council, supra*, and on

[225] *Id.* at 309, 802 A.2d at 1101-02.

[226] *Id.*

[227] *Id.* at 311, 802 A.2d at 1103.

[228] *Id.* at 314-15, 802 A.2d at 1105.

[229] *Id.*

[230] *Id.* at 315, 802 A.2d at 1105.

[231] 284 B.R. 557 (D. Md. 2002).

reconsideration, adopted the time-on-the-risk analysis, predicting that the Court of Appeals of Maryland would reach such a conclusion.[232]

The pro rata by time-on-the-risk approach is obviously a convenient, less complicated alternative. Several courts have utilized this approach in lieu of an "actual injury" allocation.

iv. Uninsured Periods

Under a "joint and several" analysis, the insured has no responsibility for uninsured periods. The triggered carriers are responsible up to their limits of liability. Under the "actual injury" and "pro rata" allocation schemes, the insured has responsibility for its share of the total loss.[233] The impact of allocation will depend on the duration of the tort-plaintiff's exposure during the policy period.

Some courts take the approach that "proration [to the insured] is appropriate as to years in which [the insured] elected not to purchase insurance or purchased insufficient insurance."[234] These courts, however, decline to prorate to the insured any years in which insurance was unavailable to the insured.

2. Claims-Made Trigger

The underwriting purpose of the "claims-made" format is to eliminate the "long tail" problems that arise with "occurrence" policies, i.e., where the injury or property damage does not occur until many years after the policy period ends. For example, in asbestos-related disease cases, the triggered policy may have been written decades before the resulting injury. In those cases, the risk was unknown when the policy was written and therefore not taken into consideration in setting the premium.

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[232] *Id*. at 559. The District Court's decision was affirmed in *The Wallace and Gale Co. v. Liberty Mut. Ins. Co*., 385 F.3d 820 (4th Cir. 2004). *See also, e.g., Nat'l Union Fire Ins. Co. of Pittsburgh v. Porter Hayden Co.,* 331 B.R. 652 (D. Md. 2005) (pro rata approach applied in asbestosis case); *Serio v. Public Serv. Mut. Ins. Co.,* 759 N.Y.S.2d 110 (App. Div. 2003) (settlement in a lead paint case should be allocated between two insurers based on each insurer's respective time on the risk).

[233] *See Mayor and City Council, supra*. In *Keene Corp., supra,* Judge Wald, in a concurring opinion, wrote: "I just do not understand why an asbestos manufacturer which has consciously decided not to insure itself during particular years of the exposure-manifestation period should have a reasonable expectation that it would be exempt from any liability for injuries that were occurring during the uninsured period." 667 F.2d at 1058.

[234] *See, e.g., Stonewall Ins. Co. v. Asbestos Claims Mgm't Corp. v. Int'l Ins. Co.,* 73 F.3d 1178, 1203 (S.D. N.Y. 1995).

The 1986 ISO policy is offered in a claims-made format. The insuring agreement provides, in pertinent part:

> This insurance applies to "bodily injury" and "property damage" only if:
>
> (1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory";
>
> (2) The "bodily injury" or "property damage" did not occur before the Retroactive Date, if any, shown in the Declarations or after the end of the policy period; and
>
> (3) A claim for damages because of the "bodily injury" or "property damage" is first made against any insured . . . during the policy period or any Extended Reporting Period. . . .[235]

The ISO CGL claims-made policy is triggered only where a claim is made *in writing* against any insured during the policy period.[236] The policy covers only bodily injury or property damage which occurs after the retroactive date and before the end of the policy period. Earlier and later injury and damage are excluded. The retroactive date will usually be the same as, or earlier than, the policy's inception date.[237] However, the insurer may eliminate the retroactive date completely.

The basic extended reporting period or "tail" is in two parts. A five-year tail exists in cases where no claim has been made but an occurrence has been reported to the insurer after the retroactive date and not later than 60 days after the end of the policy period. For all other claims there is a 60-day tail. That is, a claim that is made within 60 days of the end of the policy period is automatically covered. A supplemental tail may be purchased for an additional premium.

The distinction between claims-made and occurrence policies has been succinctly

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[235] CG 00 02 11 88 (claims-made form), © Insurance Services Office, Inc., 1988.

[236] *See, e.g., Clinical Perfusionists v. St. Paul Fire and Marine Ins. Co.,* 336 Md. 685, 650 A.2d 285 (1994) (sufficiency of notice).

[237] *See Mut. Fire, Marine & Inland Ins. v. Vollmer*, 306 Md. 243, 256, 508 A.2d 130, 136 (1986).

articulated by the U.S. Supreme Court:

> An "occurrence" policy protects the policyholder from liability for any act done while the policy is in effect, whereas a "claims-made" policy protects the policyholder only against claims made during the life of the policy.[238]

Claims-made policies permit the insurer to "underwrite the risk, compute the premiums, and establish reserves with greater accuracy" because the insurer knows its liability is limited to the term of the policy.[239]

In *Med. Mut. Liab. Ins. Soc. of Md. v. Goldstein*,[240] the Court of Appeals considered when a claim is "made" in the context of a "claims-made" medical malpractice policy. In *Goldstein*, a patient filed suit against two orthopedic surgeons, Drs. Goldstein and Blundon, in 1995. The Health Claims Arbitration Board entered an award against Dr. Blundon and in favor of Dr. Goldstein. The panel's determination was confirmed by the circuit court; the Court of Appeals affirmed the circuit court's award.

Thereafter, in 2002, Dr. Blundon filed a contribution action against Dr. Goldstein. Dr. Goldstein sought coverage from Med. Mut., under his malpractice policy which covered the period January 1, 2002 to January 1, 2003. The insurer denied coverage on the basis that Dr. Goldstein's policy was a "claims-made" policy which limited coverage to claims which are "first made against any insured during the policy period."[241] The insurer relied upon policy language stating that "all claims for damages arising out of any one 'incident' will be deemed to have been made at the time the first of those 'claims' is first made against any insured."[242] The insurer took the position that because the underlying suit against the doctors was the first claim made against the policy for damages arising out of the patient's treatment the claim was first made in 1995 and, thus, was not covered under the 2002-2003 policy.[243]

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[238] *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 535 n.3, 98 S. Ct. 2923, 2926 n.3 (1978).

[239] *Vollmer*, 306 Md. at 254, 508 A.2d at 135.

[240] 388 Md. 299, 879 A.2d 1025 (2005).

[241] *Id.* at 305, 879 A.2d at 1028.

[242] *Id.*

[243] *Id.*

The Court of Appeals rejected Dr. Goldstein's argument that the contribution action constituted an entirely new claim which was filed within the policy period. The Court noted that the claim "clearly arises from the same 'incident,' the injury to [the patient.]"[244] Therefore, under the policy, it would be deemed to have been made in 1995, when the malpractice action was filed.[245] Thus, the insurer had no obligation to defend or indemnify Dr. Goldstein in the contribution action.[246]

E. "AS DAMAGES"

The insuring agreement promises to pay all sums which the insured becomes liable to pay "as damages." This phrase has generated considerable litigation. What are "damages?" The term is not intended, for example, to include payment of fines, penalties or assessments.[247] Nor does it create a duty to defend criminal proceedings.[248]

Nowhere has conflict over coverage been as intense as in claims for environmental cleanup costs. In *Bausch & Lomb, Inc. v. Utica Mut. Ins. Co.*,[249] the Court of Appeals considered the applicability of liability insurance coverage to environmental cleanup costs. Bausch & Lomb ("B&L") was covered by a comprehensive general liability policy issued by Utica Mutual ("Utica") that did not contain a pollution exclusion.[250] B&L operated a plant for the machining and plating of telescope and microscope parts in Sparks, Maryland.[251] Upon discovering that its on-site dumping of industrial chemicals had contaminated the soil and ground water, B&L reported its findings to the appropriate governmental agencies.[252] B&L, in cooperation with state regulators, carried out further

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[244] *Id*. at 316-17, 879 A.2d at 1035-36.

[245] *Id*.

[246] Id. at 317-18, 879 A.2d at 1036.

[247] *Bausch & Lomb v. Utica Mut. Ins. Co.*, 330 Md. 758, 782-83, 625 A.2d 1021, 1033 (1993).

[248] *Jaffe v. Cranford Ins. Co.*, 214 Cal. Rptr. 567, 571 (1985); *State Farm Fire & Cas. Co. v. Superior Ct.*, 236 Cal. Rptr. 216, 218 (Cal. App. 1987); *State Farm Fire & Cas. Co. v. Superior Ct.*, 236 Cal. Rptr. 216, 218 (Cal. App. 1987).

[249] 330 Md. 758, 625 A.2d 1021 (1993).

[250] *Id*. at 764-65, 625 A.2d at 1024-25.

[251] *Id*.

[252] *Id*. at 767-68, 625 A.2d at 1025-26.

testing.[253] Although one neighboring property owner threatened suit, no suit was ever filed.[254] B&L notified Utica of the potential claim and sought reimbursement of its costs for testing and the proposed abatement costs.[255] Utica declined coverage, and filed a declaratory judgment action concerning the coverage issue. The trial court held that Utica was liable for $231,000 in cleanup costs, but not for $529,897 in testing and investigatory costs; it also awarded costs of $44,306 and attorneys' fees of $534,500.[256] The Court of Special Appeals reversed and ordered the entry of a declaratory judgment in favor of Utica.[257]

On appeal, the Court of Appeals ruled that cleanup costs are "damages."[258] The Court noted that previously "a narrow, technical definition of 'damages' had been adopted both by the Federal District Court for the District of Maryland and by the Maryland Court of Special Appeals," to except coverage for any equitable relief, such as an injunction ordering a site cleanup.[259] The Court noted its concurrence with the trial judge, who stated that the term "as damages" means "anything that a third party can make you pay for because of damage to that third party's property."[260] Therefore, it held that whether the action is legal or equitable does not affect coverage.[261] Cleanup costs are covered to the extent that they are

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[253] *Id*. at 769-70, 625 A.2d at 1026-27.

[254] *Id*. at 770, 625 A.2d at 1027.

[255] *Id*. at 767-68, 625 A.2d at 1026.

[256] *Id*. at 771-72, 625 A.2d at 1028-29.

[257] *Id*. at 773, 625 A.2d at 1028.

[258] *Id*. at 782, 625 A.2d at 1033.

[259] *Id*. at 781, 625 A.2d at 1032. *See also Md. Cas. Co. v. Armco, Inc.*, 822 F.2d 1348 (4th Cir. 1987), *cert. denied*, 484 U.S. 1008 (1988) (claim against insured by government for injunctive relief and restitution did not allege claim for damages as defined in policy); *Haines v. St. Paul Fire & Marine Ins. Co.*, 428 F. Supp. 435 (D. Md. 1977) (insurer had no duty to defend against claims seeking purely equitable relief); *Fort McHenry Lumber Co. v. Pa. Lumbermen's Mut. Ins. Co.*, Civ. A. No. HAR 88-825, 1988 WL 74843 (D. Md. Sept. 23, 1988) (same); *Md. Cup v. Employers Mut.*, 81 Md. App. 518, 568 A.2d 1129 (1990) (same). *Cf. Chesapeake Utilities Corp. v. Am. Home Assur. Co.*, 704 F. Supp. 551 (D. Del. 1989) (damages covered by insurance policy did not, as a matter of law, exclude cleanup costs imposed on insured by federal and state authorities where "damages" was not defined in policy; any definition of damages grounded upon ancient division between law and equity was not "ordinary and accepted meaning" in eyes of reasonable insured) (applying Maryland law).

[260] *Bausch & Lomb*, 330 Md. at 781, 625 A.2d at 1032.

[261] *Id*. at 781-82, 625 A.2d at 1032-33.

related to third-party property damage.[262] Although other states differ, this holding is consistent with an emerging national trend.[263]

F. REQUIREMENT OF A "SUIT"

The 2001 ISO CGL defines "suit" in the following manner:

> 18. "Suit" means a civil proceeding in which damages because of "bodily injury", "property damage" or "personal and advertising injury" to which this insurance applies are alleged. "Suit" includes:
>
> > a. An arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent; or
> > b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent.[264]

The policy provides no explanation of what constitutes a "civil proceeding in which damages are alleged," other than the subsections pertaining to arbitration and other ADR proceedings. A civil proceeding can be distinguished from a criminal or administrative proceeding in that it concerns an action in law or equity in court or in a forum the parties have contractually agreed upon, such as arbitration or ADR. Thus, if the claimant opted for a district court forum, it would be a "civil proceeding." If the claimant chose the less expensive administrative forum, that proceeding arguably would not be a "civil proceeding." This result, however, is far from certain.

Maine State Acad. of Hair Design v. Comm. Un. Ins. Co.[265] illustrates the application of this section to administrative proceedings. In *Maine State Academy of Hair Design*[266] the Supreme Judicial Court of Maine examined the definition of "suit" in

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[262] *Id.* at 780-83, 625 A.2d at 1032-33.

[263] *See generally* Carol A. Crocca, Annotation, *Liability Insurance Coverage for Violations of Antipollution Laws*, 87 A.L.R. 4th 444 (1991); 12 *Couch on Insurance 3d* §172.27 (3d ed. 2003).

[264] This provision (without part b.) first appeared in the ISO CGL form in 1986.

[265] 699 A.2d 1153 (Me. 1997).

[266] 699 A.2d 1153 (Me. 1997).

the context of a Maine Human Rights Commission Proceeding. The insurer contended that the investigatory proceeding was not a civil proceeding within the policy's definition of a suit.[267] It also argued that its duty to defend was limited to a suit seeking damages.[268] The court agreed, and based its holding on the fact that the investigatory proceeding involved no claim for damages. [269] The Court did not consider whether that proceeding could be considered "civil." Thus, the decision hinged on whether damages were sought in the administrative proceeding.

G. NUMBER OF OCCURRENCES

Both the 1973 and 1986 ISO forms limit the amount the policy will pay, in part, on a per-occurrence basis. Each occurrence may have its own deductible and/or dollar limit. Hence, the determination as to the number of occurrences may impact dramatically the amount of coverage available. The two principal tests for determining the number of occurrences are "cause" and "effect." In 1996, the Court of Appeals of Maryland joined the overwhelming majority of courts in adopting the "cause" test, which determines the number of occurrences by looking at the cause or causes of the loss.[270] The cause analysis focuses on the underlying circumstances or cause of the accident or occurrence. If there is "but one proximate, uninterrupted, and continuing cause, which resulted in all the injuries and damage," then there is one occurrence.[271] The "effect" approach focuses on the effect of the occurrence or accident.[272]

The Court of Appeals adopted the cause test in *CSX v. Continental Ins,*[273] which

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[267] *Id*. at 1159-60.

[268] *Id.*

[269] *Id*. at 1160.

[270] *See CSX v. Continental Ins.*, 343 Md. 216, 233-35, 680 A.2d 1082, 1091-02 (1996). *See generally* Michael P. Sullivan, Annotation, *What Constitutes Single Accident or Occurrence Within Liability Policy Limiting Insurer's Liability to a Specified Amount Per Accident or Occurrence*, 64 A.L.R. 4th 668, 676-79 (1988); Barry R. Ostrager and Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 7.04 (4th ed. 1991); 8A J. Appleman, *Insurance Law and Practice* § 4891.25 (1981 & 2003 Cum. Supp.); 12 *Couch on Insurance 3d* §172:19 (3d ed. 2003).

[271] *Bartholomew v. Ins. Co. of N. Am.*, 502 F. Supp. 246, 251 (D.C. R.I. 1980) (*citing Truck Ins. Exch. v. Rohde*, 303 P.2d 659, 662 (Wash. 1956)), *aff'd*, 655 F.2d 27 (1st Cir. 1981); *Sting Sec., Inc. v. First Mercury Syndicate, Inc.*, 791 F. Supp. 555, 559-60 (D. Md. 1992).

[272] *See, e.g., Kuhn's of Brownsville, Inc. v. Bituminous Cas. Co.*, 270 S.W.2d 358 (Tenn. 1954); *Gibbs v. Armovit*, 452 N.W.2d 839 (Mich. App. 1990).

[273] 343 Md. 216, 680 A.2d 1082 (1996).

involved a declaratory judgment action filed by CSX Transportation's excess insurers to determine the number of occurrences giving rise to the noise-induced hearing loss claims suffered by 20,000 former and current CSX employees. The railroad, which was responsible for self-insuring a portion of the liability for each occurrence, sought to maximize coverage by arguing that all of the claims arose out of one occurrence, i.e., the railroad's failure to protect its employees from continuous and repeated occupational noise.[274] The insurers, seeking to virtually eliminate excess coverage, argued that many different sounds, in many different places, over many different years, damaged the employees' hearing.[275] The Court upheld the sufficiency of the jury instruction and affirmed the jury's determination that there were more than 20,000 occurrences. [276]

In the lead-based paint poisoning context, two Maryland appellate cases hold that where exposure to lead occurred during multiple policy periods, each separate policy was triggered. In *United Serv. Ass'n v. Riley,*[277] the Court of Appeals held that where the plaintiff's exposure and resulting bodily injury spanned more than one policy period, the insurer's limit of liability provision did not limit liability coverage to a single per-occurrence limit. Rather, each separate policy was implicated by a "continuing occurrence." In *Md. Cas. Co. v. Hanson*, 169 Md. App. 484, 902 A.2d 152 (2006), the Court of Special Appeals held that a continuous injury trigger applied where the child had repeated exposure to lead spanning multiple policy periods. As such, the insurer's liability was not limited to a single policy's limits.[278] .

In the sexual molestation context, there has been no reported Maryland appellate decision determining the number of occurrences. However, a number of out-of-state courts have addressed this issue.[279]

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[274] *Id.* at 221, 680 A.2d at 1085.

[275] *Id*. at 236-37, 680 A.2d at 1092-93.

[276] *Id*. at 248-49, 680 A.2d at 1098.

[277] 393 Md. 55, 899 A.2d 819 (2006).

[278] *See also Scottsdale v. Am. Empire*, 811 F. Supp. 210 (D. Md. 1993) (child who had been diagnosed with lead-based paint poisoning suffered more than one bodily injury; thus, more than one policy was triggered even where the injury had not manifested itself during the policy period).

[279] *See, e.g., H.E. Butt Grocery Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 150 F. 3d 526 (5th Cir. 1998) (independent acts of abuse of two children constituted two occurrences); *Lee v. Interstate Fire & Cas. Co.*, 86 F.3d 101 (7th Cir. 1996) (concluding that question was issue of fact); *Soc. of the Roman Catholic Church of the Diocese of Lafayette and Lake Charles, Inc. v. Interstate Fire & Cas. Co.*, 26 F.3d 1359 (5th Cir. 1994) (where 31 children alleged abuse by priests, damage to each child was a separate occurrence, and each child suffered an occurrence in each policy period in which that child was molested).

H. WHO IS AN INSURED?

1. The Policy Language

The 1973 ISO policy's "Persons Insured" section provides that the following persons are insured:

a. The Named Insured, if an individual, (and spouse) but only with respect to the conduct of a business of which he is the sole proprietor.

b. Any partner in a partnership (and spouse), but only with respect to partnership liability.

c. Any executive officer, director or stockholder of an insured corporation, but only with respect to their duties as such.

d. Any real estate manager for the named insured (except an employee).

e. Any person operating mobile equipment on a public highway with the permission of the named insured.

The policy specifically excludes coverage for unnamed partnerships.

The equivalent section of the ISO's 1986 form, entitled "Who is an Insured," is quite similar. However, there are several important differences. For example, employees are automatic insureds under the 1986 ISO policy unless specifically excluded. Employees are only insured, however, within the scope of their employment or while performing employment-related duties.

Under the 1973 ISO policy, employees were insureds only with respect to liability arising from the operation of mobile equipment. The 1986 form also excludes coverage for suits by an employer against his employees and coverage for employees arising from the provision or failure to provide health care services. Further, the 1986 form excludes liability for past and current partnerships and joint ventures. Real estate managers are automatic insureds under both forms.

2. Coverage For Employees

Both the 1986 ISO CGL and the BFCGL Endorsement provide employees with coverage, "but only for acts within the scope of their employment by [the named insured]

or while performing duties related to the conduct of [the named insured's] business."[280] The "while performing duties" provision is not simply a temporal-spatial standard covering acts while at the place of employment and during working hours.[281] The duty that gives rise to the action must be related to the conduct of the employer's business.[282]

In *Selective Ins. Co. v. Oglebay*,[283] the insurer filed a declaratory judgment action to determine coverage in connection with a claim against the insured driving school by a mentally disabled woman who was sexually molested by the insured's employee, a driving instructor. The policy at issue provided that the term "insured" included "employees . . . but only for acts within the scope of their employment by [the insured] or while performing duties related to the conduct of [the insured's] business."[284]

The issue before the Court was whether the driving instructor's acts were committed "while performing duties related to the conduct" of the insured's business.[285] Noting that Maryland courts had not yet interpreted the "while performing duties" provision, the Court examined a case in which it had addressed the interpretation of a similar provision under Virginia law.[286] In that case, *Fed. Ins. Co. v. Ward*, [287] the issue was whether an employee who was locking up the premises after a day of work was acting "while performing duties related to the conduct of [the employer's] business" when she flicked cigarette ashes into a wastebasket, resulting in a fire.[288] The Court stated,

> We conducted our analysis [in *Ward*] by identifying the discreet [sic] act in question, flicking cigarette ashes, and comparing that with her duties as an employee: "Indeed, because the act of smoking was not within the

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[280] CGL II.2.a.

[281] *See Selective Ins. Co. v. Oglebay*, No. 05-2357, 2007 WL 2046860 (4th Cir. 2007) (Md. law).

[282] *Id*.

[283] No. 05-2357, 2007 WL 2046860 (4th Cir. 2007) (Md. law).

[284] *Id*. at *1.

[285] The parties had agreed that, under Maryland law, the intentional acts committed by the driver were not "within the scope of his employment." *Id*. at *2.

[286] *Id*. at *3.

[287] 166 Fed. Appx. 24 (4th Cir. 2006).

[288] *Oglebay*, 2007 WL 2046860 at *3.

> Employees' job description or needed to perform a job-related duty, the subsidiary act of flicking ashes also cannot be characterized as the exercise of a duty."[289]

The Court reasoned,

> In this case [*Oglebay*], the act complained about is false imprisonment arising from sexual abuse and sexual assault. There is no suggestion that sexual contact in any form constituted part of [the driving instructor's] job description nor that the subsidiary act of accomplishing it in an assaultive way could be characterized as the exercise of a duty.[290]

The Court also examined a Maryland case, *Wolfe v. Anne Arundel County*,[291] in which the Court of Appeals determined whether a lawsuit resulting from a rape committed by an on-duty police officer was covered by an agreement that provided coverage for "litigation arising out of acts within the scope of his/her employment."[292] In *Wolfe*, the rape victim argued that "but for" the police officer's position, he could not have gained access to and control of the victim and would not have had the opportunity to rape her.[293] The *Wolfe* court disagreed, noting that the lawsuit arose out of the act of raping the victim, not the act of performing a traffic stop. Thus, there was no coverage.[294]

The *Oglebay* Court concluded,

> In this case [the insured's] business was providing driving instruction. . . [The driving instructor's] duties were to teach his students . . . how to drive. It is undisputed, however, that the [driving instructor] was not teaching [the plaintiff] how to drive during the times that [she] was with him. Rather, [the driving instructor] sexually assaulted [the plaintiff] in lieu of performing his duties, i.e. providing driving instruction. [His] sexual assault of [the plaintiff], even if committed during the time or at place related to his employment as a

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[289] *Id*.

[290] *Id*.

[291] 374 Md. 20, 821 A.2d 52 (2003).

[292] *Oglebay*, 2007 WL 2046860 at *3.

[293] *Id*.

[294] *Id.*

driving instructor, was certainly not the performance of a duty related to the conduct of his employer's business.[295]

Both the 1986 ISO CGL and the BFCGL Endorsement except coverage where the action is brought against an employee by a fellow employee. This exception from coverage, sometimes called the "fellow-employee," "cross-employee," or "co-employee" exception, is designed to coordinate liability coverage with workers' compensation insurance and employer's liability insurance.[296]

The fellow-employee exception presents more problems in Maryland than in most other states because Maryland is one of the few states where an employee can sue a co-employee.[297] The issue may arise between two employees of the same employer, or between an employee and a statutory employee.[298] Compare the auto insurance policies, where the fellow-employee limitation (which appears in the exclusion section of the policy) is not enforceable up to the statutory minimum limits, but is enforceable above those limits.[299]

3. Additional Insureds

The ISO policy specifically lists "named insureds" on the Declaration page. Others may achieve insured status automatically by falling within the policy's definition of an insured. A third category is "additional insureds." These are persons who are not

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[295] The Court also rejected the argument by the insured's assignee that coverage should be available for "false imprisonment," noting that although the complaint contained a claim for false imprisonment, the factual allegations supporting that claim arose exclusively from the sexual misconduct of the driving instructor. *Id*. at *4.

[296] *See generally* 7A J. Appleman, *Insurance Law and Practice* § 4500.05 (Berdal ed. 1979 & 2003 Cum. Supp.); 8 *Couch on Insurance 3d* § 115:15 (3d ed. 2003); Andrew Janquitto, *Maryland Motor Vehicle Insurance* § 7.11(D) (2d ed. 1999); Robert A. Shapiro, Annotation, *Construction and Application of Provision of Liability Policy, Other than Automobile Liability, Excluding From Coverage Injury or Death of Employee of Insured*, 34 A.L.R. 3d 1397 (1970).

[297] *See Athas v. Hill*, 300 Md. 133, 476 A.2d 710 (1984).

[298] *See Hastings v. Knott, Inc.*, 114 Md. App. 403, 689 A.2d 1323 (1997) (subcontractor's worker was "co-employee" of contractor's worker; thus, there was no coverage in connection with injury by one to the other); *Riviera Beach Vol. Fire Co. v. Fidelity & Cas. Co.*, 388 F. Supp. 1114 (D. Md. 1975) (paid and voluntary firemen were "fellow employees"; thus, insurer had no duty to defend fireman alleged to have caused injuries to fellow employees as a result of an accident involving a vehicle he was driving and in which they were passengers).

[299] *See Wilson v. Nationwide Mut. Ins. Co*., 395 Md. 524, 910 A.2d 1122 (2006); *Larimore v. Am. Ins. Co.*, 314 Md. 617, 622 n.2, 552 A.2d 889, 891 n.2 (1989).

automatically included in the policy, but for whom the named insured wishes, or is required, to provide coverage.[300] These "additional insureds" are usually added by endorsement. ISO provides at least twenty-nine "additional insured" forms.[301] Manuscript "additional insured" endorsements are also often employed. Each additional insured's rights are governed by its contract.

Some insureds are routinely required by contract to name other entities as additional insureds. To avoid breach of contract claims if the additional insured status is not arranged, some policies are endorsed to name automatically as additional insureds those who are entitled to such status by agreement with the named insured. Since 1997, two standard blanket additional insured endorsements have been available to fill this need: Additional Insured-Owners, Lessees or Contractors-Automatic Status When Required in Construction Agreement With You (CG 20 33); and Additional Insured-Lessor of Leased Equipment-Automatic Status When Required in Lease Agreement With You (CG 20 34). The insurer will usually add such a party as an additional insured for a small additional premium.

The purpose of making an entity an additional insured usually involves a joint enterprise. Where two parties to a contract share a common risk, the contract frequently imposes on the party with the most control over the risk a duty to have the other party named as an additional insured on its liability policy. For example, contractors frequently require subcontractors, and landlords frequently require tenants, to name them as "additional insureds" in their liability policies.[302]

Additional insured status has several advantages over contractual liability coverage. First, an insurer may be less stubborn than an indemnitor in accepting a duty to pay for legal fees or indemnity. Second, an insurer is more likely to be solvent. Third, indemnity agreements may be barred by statute, while additional insured status is not.[303]

Additional insured status also has certain disadvantages for the named insured and the additional insured. The named insured and the additional insured share the policy

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[300] Donald Malecki, Pete Ligeros and Jack Gibson, *The Additional Insured Book* 57 (IRMI 4th ed. 2000).

[301] These endorsements are tailored to specific needs, such as condominium unit owners, owners/lessees/contractors, or vendors.

[302] *See, e.g., G.E. Tignall & Co. v. Reliance Nat'l Ins. Co.*, 102 F. Supp. 2d 300 (D. Md. 2000) (certificate of insurance not binding on insurer); *BGE v. Commercial Union*, 113 Md. App. 540, 688 A.2d 496, 514-15 (1997) (subcontractor agreement).

[303] *See, e.g.*, Md. Code Ann., Cts. & Jud. Proc. § 5-305 (1998) (barring certain indemnity agreements); *see generally* Malecki and Gibson, *supra* note 300.

limits.[304] Moreover, many large insureds are actively involved in defending lawsuits against them. As additional insureds, they may lose control of the defense to another company's insurance carrier.[305]

Many additional insured endorsements limit the entity's status as an insured to "liability arising out of…" the named insured's operations.[306] "Arising out of" is a phrase that is used in indemnity agreements, automobile insurance policies, and several sections of general liability policies.[307] What does "arising out of" mean? Does it mean liability proximately caused by the named insured or merely liability connected with the named insured's work? [308]

Maryland appellate courts have consistently applied a broad interpretation to the term "arising out of," as noted by the U.S. District Court for the District of Maryland:

> The phrase "arising out of" has been broadly interpreted under Maryland law. The Court of Appeals has explained that "the words 'arising out of' must be

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[304] Malecki and Gibson, *supra* note 300.

[305] *Id.*

[306] *See, e.g., G.E. Tignall v. Reliance Nat'l Ins. Co.*, 102 F. Supp. 2d 300, 305 (D. Md. 2000); *BGE v. Commercial Union*, 113 Md. App. 540, 557-58, 688 A.2d 496, 504-05 (1997).

[307] *See, e.g., State Farm Mut. Auto. Ins. Co., v. DeHaan*, 393 Md. 163, 900 A.2d 208 (2006) (automobile insurance policy); *Mass Transit v. CSX*, 349 Md. 299, 300-02, 708 A.2d 298, 299-301 (1998) (indemnification provision in state procurement contract); *N. Assur. Co. of Am. v. EDP Floors, Inc.*, 311 Md. 217, 533 A.2d 682 (1987) (general liability coverage); *Nat'l Indem. Co. v. Ewing*, 235 Md. 145, 149, 200 A.2d 680, 682 (1964) (automobile insurance).

[308] "Proximate cause" consists of two elements: (1) cause-in-fact and (2) legally cognizable cause. *See, e.g., May v. Giant Food, Inc.*, 122 Md. App. 364, 383, 712 A.2d 166, 175 (1998) (causation in fact is concerned with whether the defendant's conduct produced the plaintiff's injury), *cert. denied*, 351 Md. 286, 718 A.2d 234 (1998); *Peterson v. Underwood*, 258 Md. 9, 16-17, 264 A.2d 851, 855 (1970) (causation in fact is concerned with whether the defendant's conduct actually produced an injury; proximate cause ultimately involves a conclusion that someone will be held legally responsible for the consequences of an act or omission based not only upon causation in fact but also upon considerations of fairness and social policy). The "but-for" test may be used to determine whether cause-in-fact exists. Prosser and Keeton define the but-for test as:

> The Defendant's conduct is a cause of an event if the event would not have occurred but for that conduct; conversely, the Defendant's conduct is not a cause of the event if the event would have occurred without it.

W. Page Keeton, et al., *Prosser and Keeton on the Law of Torts*, § 41 at 266 (5th ed. & Supp. 1998).

afforded their common understanding, namely, to mean originating from, growing out of, flowing from or the like."[309]

This is similar to a but-for analysis. If the loss would not have occurred but for the named insured's operations or the additional insured's negligence in supervising the named insured, then the endorsement is triggered.[310] If, on the other hand, the loss was due solely to the additional insured's own active negligence, the endorsement should not apply.[311] At least one court has found a similar endorsement ambiguous.[312]

The leading case in Maryland analyzing the phrase "arising out of" is *Mass Transit v. CSX*. [313] There, the Court was called upon to analyze the phrase in the context of an indemnity agreement. The MTA executed a Commuter Rail Passenger Service Agreement ("Contract") with CSX Transportation ("CSXT") to run the MARC train. MTA agreed to indemnify, hold harmless, and defend CSXT from any and all casualty losses, claims, suits, damages or liability of every kind *arising out of* the Contract.[314] CSXT hired Benhoff to pave four railroad crossings over CSXT tracks. The dispatcher had not received advanced notice of the re-paving work sufficient to warn the MARC train operators. A MARC train operated by CSXT hit and destroyed a Benhoff backhoe

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[309] *Beretta U.S.A. Corp. v. Fed. Ins. Co.*, 117 F. Supp. 2d 489, 493 (D. Md. 2000) (*citing N. Assur. Co. v. EDP Floors, Inc*., 311 Md. 217, 230, 533 A.2d 682, 688 (1987)) (citations omitted). *See also G.E. Tignall & Co. v. Reliance Nat'l Ins. Co.*, 102 F. Supp. 2d 300, 305-06 (D. Md. 2000) (subcontractor's insurance did not apply to general contractor where subcontractor was not a named defendant and the complaint did not allege vicarious liability); *Nat'l Union Fire Ins. Co. v. CSX Corp.*, 982 F. Supp. 1050, 1052 (D. Md. 1997) (railroad exclusion for damages "arising out of loading or unloading of any railcar or railroad operation" unambiguously excluded injuries incurred as a result of insured's loading of railcar involved in train accident); *Mass Transit v. CSX*, 349 Md. 299, 311-12, 708 A.2d 298, 305 (1998) ("arising out of" implies "but-for" causation, rather than proximate or "intermediate" causation)*; Aragona v. St. Paul Fire & Marine Ins. Co.*, 281 Md. 371, 378-79, 378 A.2d 1346, 1350 (1977) (in legal malpractice policy "arising out of" requires direct and precipitating cause); *Frazier v. UCJF Board*, 262 Md. 115, 118-19, 277 A.2d 57, 59 (1971) (where an unknown motorist threw a cherry bomb into the claimant's car, the resultant bodily injury arose out of the ownership, operation or use of an unidentified motor vehicle).

[310] *G.E. Tignall & Co. v. Reliance Nat'l Ins. Co.*, 102 F. Supp. 2d 300, 306 (D. Md. 2000); *BGE v. Commercial Union*, 113 Md. App. 540, 557, 688 A.2d 496, 504 (1997).

[311] *Id.*

[312] In *Heat & Power Corp. v. Air Products & Chemicals, Inc.*, 320 Md. 584, 597, 578 A.2d 1202, 1209 (1990), where the endorsement made the owner an additional insured but "only in connection with work performed by the named insured for [Owner]," the Court found the endorsement ambiguous.

[313] 349 Md. 299, 708 A.2d 298 (1998).

[314] *Id.* at 301, 708 A.2d at 300.

left on the tracks that Benhoff was re-paving.[315] Benhoff sued CSXT, but not the MTA, and ultimately settled for $23,230. CSXT sought indemnification from MTA, alleging that the work CSXT contracted Benhoff to perform was necessary to CSXT's performance under the Contract, and that the MARC train that struck the Benhoff backhoe was performing work under the contract.[316]

The Court of Appeals rejected an "intermediate causation" standard proposed by the MTA and reasoned that the phrase "arising out of" work under the contract was to be interpreted under a "physical causation or causation in fact" standard.[317] The Court analogized this contract to insurance policies and interpreted the meaning of "arising out of" as "originating from, growing out of, flowing from, or the like."[318] This is a broader meaning than "proximate cause."[319] Proof of proximate cause, while a requisite for tort liability, is unnecessary to satisfy this contract law standard.[320] Thus, the indemnity was enforceable regardless of whether the accident was due to CSXT's negligence.[321] Since contract law applied, "but for" causation was all that was required.[322]

The *CSX* Court relied in its analysis upon an out-of-state decision, *O'Conner v. Serge Elevator Co*. In *O'Conner,*[323] a drywall subcontractor's employee was on his way out of the construction project site for a lunch break when he was struck by an elevator.[324] The employee sued the general contractor. The general contractor sued the drywall subcontractor under the indemnification clause contained in the contract. That clause provided for indemnification "includ[ing] personal injuries 'arising out of the

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[315] *Id.* at 303, 708 A.2d at 300-01.

[316] *Id.* at 304, 708 A.2d at 301.

[317] *Id.* at 321, 708 A.2d at 309.

[318] *Id.* at 311-19, 708 A.2d at 305-09 (quoting *N. Assur. Co. of Am. v. EDP Floors*, 311 Md. 217, 230-31, 533 A.2d 682, 688-89 (1987)).

[319] *Id.* at 321, 708 A.2d at 309-10.

[320] *Id.*

[321] *Id.*

[322] *Id.*

[323] 444 N.E.2d 982 (N.Y. 1982).

[324] *Id.* at 983.

work which is the subject of this contract.'"[325] The New York Court of Appeals held that the subcontractor's indemnification clause applied, as "[t]he contract could not be performed… unless [the subcontractor's] employees could reach and leave their workplaces on the job site. The instant injuries, occurring during such movement, must be deemed as a matter of law to have arisen out of the work."[326]

The *CSX* Court applied this standard to the case before it: that is, whether the liability incurred by CSXT "arose out of" the Contract and therefore entitled CSXT to indemnification by the MTA. The Board of Contract Appeals found the work to be outside the scope of the contract, but on appeal, the Court of Special Appeals found that the MARC train operation was work conducted within the scope of the contract.[327] The issue was not disputed at the Court of Appeals level, so the Court of Appeals applied the Court of Special Appeals' analysis and determined that the work was within the scope of the contract.[328] The Court reasoned: "So long as the liability of CSXT arises out of the Contract … it matters not that MTA [i.e. the MARC train] is not at fault."[329] The Court of Appeals concluded that the accident occurred when the MARC train struck Benhoff's backhoe, and the MARC train was operated by CSXT, i.e., MTA's agent. Thus, MTA was, at the moment of impact, liable for the damage to Benhoff's backhoe, so that CSXT was entitled to indemnification by MTA.[330]

Two other appellate decisions which appear to apply a narrower rule to limit the application of the phrase "arising out of" in the additional insured endorsements to vicarious liability or imputed liability are *BGE v. Commercial Union*[331] and *G.E. Tignall & Co. v. Reliance Nat'l Ins. Co.*[332] Several other decisions, in other contexts, apply a proximate cause-type analysis.[333]

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[325] *Id.*

[326] *CSX*, 349 Md. at 317-18, 708 A.2d at 308.

[327] *Id.* at 305, 708 A.2d at 301-02.

[328] *Id.* at 305-06, 708 A.2d at 302-03.

[329] *Id.* at 317, 708 A.2d at 307.

[330] *Id*.

[331] 113 Md. App. 540, 688 A.2d 496 (1997). *BGE* was decided prior to *CSX*.

[332] 102 F. Supp. 2d 300 (D. Md. 2000).

[333] *See, e.g., Philadelphia Indem. Ins. Co. v. Md. Yacht Club,* 129 Md. App. 455, 479, 742 A.2d 79, 92 (1999) (in construing a Directors and Officers Liability policy with an exclusion for liability "arising out of" bodily injury, the

The 1996 ISO revisions[334] to the "Other Insurance" condition make clear that the named insured's policy is excess over the policy in which it is an additional insured.[335]

III. EXCLUSIONS

Most liability policies start with a broad grant of coverage and then limit that grant with exclusions. Exclusions generally fit into one of four categories. First, exclusions serve the purpose of avoiding duplication of coverage. For example, Homeowners and CGL policies exclude risks covered by automobile insurance. Second, exclusions can identify risks for which some, but not all, insureds need coverage so that risks may be separately purchased, e.g., contractual liability insurance, product recall, etc. Third, policy exclusions eliminate business risks, those risks which are inherent in the insured's business and that the insured should control: the quality of the product or service. Fourth, exclusions eliminate risks that the insurer cannot measure or that are too great to undertake. For example, no one wants to insure a home built next to a dynamite factory.

Some states construe insuring clauses broadly and exclusions narrowly.[336] Maryland does not follow this rule and construes both insuring clauses and exclusions as any other contract.[337] Exclusions are not to be construed together to create an ambiguity. Each exclusion must be independently applied to the insuring clause.[338]

Court held that the exclusion did not bar coverage for a wrongful discharge action instituted against the insureds by a former employee who claimed he was fired from his job because of a work-related injury because the nexus between the wrongful discharge action and the bodily injury exclusion was too attenuated); *Webster v. Gov't Employees Ins. Co*., 130 Md. App. 59, 744 A.2d 578 (1999) (when a passenger was killed when the driver accelerated to escape an attempted carjacking, her injuries did not arise from use of the vehicle); *Wright v. Allstate Ins. Co.*, 128 Md. App. 694, 740 A.2d 50 (1999) (where a man got out of his car, approached a vehicle that had stopped at a stop sign, and shot the driver and a passenger, the injuries did not arise out of the use of the automobile).

[334] ISO refers to these as the 1996 revisions although they were first available in 1997.

[335] *See, e.g.,* CG 00 55, a mandatory endorsement to the policy.

[336] *See, e.g., Glens Falls Ins. Co. v. Donmac Golf Shaping Co., Inc.*, 417 S.E.2d 197, 201 (Ga. App. 1992); *see generally* 13 J. Appleman, *Insurance Law and Practice* § 7405 (1976).

[337] *See, e.g., Pac. Indem. Co. v. Interstate Fire & Cas. Co.*, 302 Md. 383, 488 A.2d 486 (1985).

[338] *Century I Joint Venture v. U.S.F.&G.*, 63 Md. App. 545, 558-59, 493 A.2d 370, 377-78 (1985).

A. THE INTENTIONAL INJURY EXCLUSION

Intentional injuries are excluded from coverage under most insurance policies. This limitation on coverage is referred to as the "intentional injury exclusion." In the 1973 ISO CGL policy, the intentional injury exclusion was found in the definition of "occurrence."

"Occurrence" is defined as follows:

> Occurrence means an accident including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.

In the 1986 policy, the phrase "neither expected nor intended from the standpoint of the Insured" was moved from the insuring clause to exclusion "a." The new exclusion provides:

This insurance does not apply to:

> a. "Bodily injury" or "property damage" expected or intended from the standpoint of the insured. This exclusion does not apply to "bodily injury" resulting from the use of reasonable force to protect persons or property.

This new exclusion separates the requirement of fortuity, an "accident," from the no intent to harm requirement, "neither expected nor intended."[339] However, both play a part in excluding non-fortuitous losses.

The exclusion finds its underpinnings in both the essential nature of insurance and in public policy considerations.[340] Insurance policies are designed to cover only fortuitous events. The "'business principle' . . . is that an insured seeks the safety of insurance against risks that are outside his control and the insurer agrees to cover for a premium based on actuarial calculations of the random occurrence (risk) of such events in a given population."[341] Where the insured intentionally causes the injury, he controls the risk.

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[339] *See* discussion *supra* § II A.

[340] *See generally* Ellen S. Pryor, *The Stories We Tell: Intentional Harm and the Quest for Insurance Funding*, 75 Tex. L. Rev. 1721 (1997).

[341] *Transamerica Ins. Group v. Meere*, 694 P.2d 181, 185-86 (Ariz. 1984).

Since the premium is calculated based on the risk of accident, this falls outside the insurer's calculations and within the "intentional injury" exclusion.[342] The public policy goal behind this clause is to "prevent an insured from acting wrongfully with the security of knowing that his insurance company will 'pay the piper' for the damages."[343]

The development of the exclusion is informative. The CGL policy added the "neither expected nor intended from the standpoint of the insured" language to the definition of occurrence during the 1966 major revisions. [344] The purpose of the phrase is to clarify the concept of "accident" (i.e., neither expected nor intended) and to clarify from whose perspective the accidental nature of the event will be judged (i.e., the standpoint of the insured or "a reasonable insured").[345]

Whether the insured intended the injury seems a simple question, but its application has resulted in a wide variety of results. Commentators have categorized the cases and tests in different ways.[346] Three useful categories are:

(1) an "objective test," denying coverage where a "reasonable insured would have foreseen the injuries resulting from his intentional actions";

(2) a "subjective test," denying coverage "only upon a finding that the insured actually intended both the act and the precise injury which resulted"; and

(3) an "inferred-intent test," requiring sufficient evidence to impute "to the insured as a matter of law an intent to cause harm based on the nature and circumstances of the insured's action."[347]

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[342] *Id.*; *See generally Bituminous Cas. Corp. v. Bartlett*, 240 N.W.2d 310, 313 (Minn. 1976); 7A J. Appleman, *Insurance Law & Practice* § 4492.01(Berdal ed. 1979 & 2003 Cum. Supp.); L. Stuart Griggs, *The Intentional Injury Exclusion: When is There No Intent Behind the Intention?*, 11 Am. J. Trial Advoc. 527 (Spring 1988).

[343] *Meere*, 694 P.2d at 186.

[344] *Patrons-Oxford Mut. Ins. Co. v. Dodge*, 426 A.2d 888 (Me. 1981) (reviewing the history of this clause.).

[345] *Id.*, 426 A.2d at 890 n.18; *see also* James L. Rigelhaupt, Jr., Annotation, *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 A.L.R. 4th 957 (1984).

[346] One commentator found five different categories of cases. *See* Griggs, *supra* note 342.

[347] *See* Tracy E. Silverman, *Voluntary Intoxication: A Defense to Intentional Injury Exclusion Clauses in Homeowner' s Policies?*, 90 Mich. L. Rev. 2113, 2120-25 (June 1992).

While it may be handy for commentators to separate cases into distinct categories, no shorthand test explains the Maryland courts' analysis. A close examination of the Maryland case law is necessary.

1. Maryland Case Law

The intentional injury exclusion requires that the injury be both accidental and unintended. Frequently, the act is intentional (such as driving a car through a red light) but the injury is not (the automobile property damage and personal injury which result). Whether an injury is subjectively intentional, and hence non-accidental, may be judged by several different standards.[348] How is subjective intent to be judged? May the insured escape this exclusion simply by stating that he did not intend the harm? Or may the insured's subjective intent to harm be inferred from the nature and circumstances of his actions? Generally, Maryland courts will find intent if the injuries are of the general type that might be expected from the insured's conduct, even though the actual injury is not intended and may even be more severe than intended. However, if the injuries are of a different type and degree from what might be expected, it may be a factual question.

The Court of Special Appeals refused to find intent in *Allstate v. Sparks*.[349] There, the insured was stealing gasoline when the fumes ignited, causing a fire that destroyed a mill building. The homeowner's policy excluded "property damage which is either expected or intended from the standpoint of the Insured."[350] The Court held that to bar coverage, the insured must have intended the injury, not merely the act that caused the damage.[351] Sparks clearly intended to steal gasoline, but never intended to start a fire.[352] Therefore, the Court stated, even foreseeable injuries that result from the insured's intentional acts are not excluded, unless the insured intended those results.[353]

A different result was obtained in *Harpy v. Nationwide Mut. Fire Ins*.[354] There, the

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[348] *See generally* James L. Rigelhaupt, Jr., Annotation, *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 A.L.R. 4th 957 (1984).

[349] 63 Md. App. 738, 493 A.2d 1110 (1985).

[350] *Id*., 493 A.2d at 1111-12.

[351] *Id*., 493 A.2d at 1113.

[352] *Id*.

[353] *Id*., 493 A.2d at 1112-13.

[354] 76 Md. App. 474, 545 A.2d 718 (1988).

Court of Special Appeals construed another homeowner's policy as applied to the sexual molestation of a minor. The Court distinguished *Sparks* and clarified the rule:

> There is no *substantial certainty* that one stealing gasoline will start a fire. There is, however, substantial certainty that sexual molestation of a child by her father over an extended period of time will cause that child to suffer serious harm. . . . While it is true that an intended act causing unintentional injury, under some circumstances, can be considered negligence, [a]s the probability of injury to another, apparent from the facts within his knowledge, becomes greater, his conduct takes on more of the attributes of intent, until it reaches that *substantial certainty* of harm which juries, and sometimes courts, may find inseparable from intent itself.[355]

The "substantial certainty" rule requires more than mere foreseeability.[356] Foreseeability is an element of most torts; thus, a foreseeability rule would result in no coverage in all cases because the very thing that triggers the insured's liability would exclude coverage. Whether the "bodily injury" or "property damage" which actually occurs is "substantially certain," and hence intentional or "expected or intended," is usually an issue to be determined by the trier of fact, although in certain situations the intent to harm may be inferred. [357] Whether this is the test the Court of Appeals will ultimately adopt will have to wait upon further

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[355] *Id*. at 483-84 (emphasis added) (*citing Ghassemieh v. Schafer*, 52 Md. App. 31, 41, 447 A.2d 84, 89, *cert. denied*, 294 Md. 543 (1982)).

[356] In *Gearing v. Nationwide Ins. Co.*, 665 N.E.2d 1115 (Ohio 1996), the Court reasoned:

> [I]n those cases where an intentional act is substantially certain to cause injury, determination of an insured's subjective intent, or lack of subjective intent, is not conclusive of the issue of coverage. Rather, an insured's protestations that he "didn't mean to hurt anyone" are only relevant where the intentional act at issue is not substantially certain to result in injury.

Id. at 1119.

[357] "The crucial question in determining when intent to injure may be inferred as a matter of law, or when this issue involves a factual question for the jury to decide, is whether the conduct alleged is of such a nature that injury or harm is substantially certain to result. . . . There must be a "degree of certainty that the conduct will cause injury. . . sufficiently great to justify inferring intent to injure as a matter of law." *A.O. Smith Corp. v. Allstate Ins. Cos*., 588 N.W.2d 285, 294-95 (Wis. App. 1998) (citations omitted). Fraud, conspiracy to commit fraud, mail fraud under RICO and conversion are allegations where the intent to harm or injure can be inferred as a matter of law. *Id. See also Bruner v. Heritage Cos.*, 593 N.W.2d 814 (Wis. App. 1999); *Am. Home Assur. v. Osbourn*, 47 Md. App. 73, 422 A.2d 8 (1980) (conversion excluded) (dicta).

decisions.

2. Problem Fact Patterns

Certain vexatious situations arise frequently. Assault and battery cases, for example, have received mixed results from the courts. These cases frequently arise under homeowners' policies which have "intent to injure" exclusions quite similar to the 1973 ISO policy. Many of the cited cases involve those policies rather than CGL policies. Situations where harm is likely, but not necessarily intended, test the elasticity of the CGL policy.

a. Assault and Battery

The basic purpose of the intentional injury exclusion is to prevent the insured from benefiting financially when he intentionally harms someone.[358] Usually, determining the duty to indemnify is straightforward. If the jury finds that an assault or battery occurred, the intentional injury exclusion applies.

The difficult issues are presented by the duty to defend.[359] Maryland appellate courts have decided a number of assault and battery cases and appear to apply differing tests of intent.[360] It is important to note that if in the course of committing an assault, the person committing the assault comes into contact with the person assaulted, the element of intent to commit battery is supplied by the intent to commit assault.[361]

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[358] *Globe Am. Cas. Co. v. Lyon*, 641 P.2d 251, 253-54 (Ariz. App. 1982).

[359] *See, e.g., Aetna Cas. & Sur. Co. v. Cochran*, 337 Md. 98, 651 A.2d 859 (1995).

[360] *See, e.g., Lititz Mut. Ins. Co. v. Bell*, 352 Md. 782, 724 A.2d 102 (1999) (patient suffering from "intermittent explosive disorder" was nonetheless able to form intent necessary to deliberately cause injury to another); *Pettit v. Erie Ins. Exch.*, 349 Md. 777, 709 A.2d 1287 (1998) (homeowner's policy exclusion for injuries expected or intended by insured applied to insured's sexual molestation of children despite insured's subjective belief that conduct caused no harm); *Aetna Cas. & Sur. Co. v. Cochran*, 337 Md. 98, 651 A.2d 859 (1995) (policy covered bodily injury resulting from use of reasonable force to protect persons or property even if bodily injury was expected or intended by insured); *Eastern Shore Fin. Res., Ltd. v. Donegal Mut. Ins. Co.*, 84 Md. App. 609, 581 A.2d 452 (1990) (no potential for coverage existed where insured struck police officer while trying to evade arrest). *See also Northfield Ins. Co. v. Boxley*, 215 F. Supp. 2d 656 (D. Md. 2002) (under Maryland law, fact that insured's employee, while arguing with visitor, fired gun into street and not at visitor, did not create issue of possibility of lack of intent, since employee did not have to intend to kill or injure visitor in order to commit battery; thus, assault and battery exclusion in CGL was applicable to claims arising out of visitor's death from ricocheted bullet); *Blue Ridge Ins. Co. v. Puig*, 64 F. Supp. 2d 514, 518 (D. Md. 1999) (intentionally kicking in a bathroom stall door to frighten a victim constituted a battery even if the kicker did not intend for the door to hit the victim); *see generally Brohawn v. Transamerica Ins. Co.*, 276 Md. 396, 347 A.2d 842 (1975).

[361] *Nelson v. Carroll*, 355 Md. 593, 605, 735 A.2d 1096, 1102 (Md. 1999).

Some policies have specific "assault and battery" exclusions.[362] The Court of Special Appeals of Maryland addressed such an exclusion in *7416 Baltimore Ave. Corp. v. Penn-America Ins. Co.*[363] In *7416 Baltimore Ave. Corp*., a nightclub patron sued a nightclub, alleging that he was forcibly evicted from the nightclub by bouncers. His complaint was in two counts: the first based upon a theory of assault and battery and the second based on the theory that the nightclub was negligent in supervising the bouncers.[364] The nightclub's insurance policy contained the following endorsement:

> In consideration of the premium charged, it is hereby understood and agreed that this policy excludes claims arising out of Assault and Battery, whether caused by or at the instigation of, or at the direction of, the insured, his employees, patrons or any cause whatsoever.[365]

In considering the application of the exclusion to the claims against the insured, the Court observed:

> Clearly, if an assault and battery is established [the insurer] owes no damages on behalf of the insured. If, on the other hand, the trier of fact concludes that no assault occurred due to no intent to commit a battery or that the insured acted in self-defense, the potentiality for coverage exists if the fact-finder concludes that an injury resulted from the negligent failure to instruct employees on the lawful manner of resolving disputes with patrons.[366]

Given the possibility of a covered claim, the Court concluded that the insurer had a duty to defend the insured against the patron's claims.[367]

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[362] *See generally* Kimberly J. Winbush, Annotation, *Validity, Construction and Effect of Assault and Battery Exclusion in Liability Insurance Policy at Issue*, 44 A.L.R. 5th 91 (1996).

[363] 83 Md. App. 692, 577 A.2d 398 (1990).

[364] 83 Md. App. at 696, 577 A.2d at 399.

[365] *Id*. at 696, 577 A.2d at 399.

[366] *Id*. at 699, 577 A.2d at 401.

[367] *Id*. at 701, 577 A.2d at 402. Where a plaintiff alleges negligence, but the claim clearly is based upon an intentional act, the court may conclude that coverage is not available. *See, e.g., Kamaki Skiathos, Inc. v. Essex Ins. Co*., 396 F. Supp. 2d 624 (D. Md. 2005) (coverage not available where plaintiff's negligence count was based upon allegation of intentional acts); *Standard Fire Ins. Co. v. Proctor*, 286 F. Supp. 2d 567 (D. Md. 2003) (in situation in

The *7416 Baltimore Ave. Corp*. case was followed by a quartet of Federal Court cases applying Maryland law: *Kamaki Skiathos, Inc. v. Essex Ins. Co.*,[368] *Northfield Ins. Co. v. Boxley*,[369] *First Financial Ins. Co. v. GLM, Inc*.,[370] and *Sphere Drake Ins., PLC v. Carolina Restaurant, Inc.*[371]

Cases such as *7416 Baltimore Ave. Corp*. led insurers to craft more comprehensive assault and battery exclusions, such as the following:

> **EXCLUSION – ALL ASSAULT OR BATTERY**
> The following exclusion is added to Paragraph 2. Exclusions of SECTION I – COVERAGES
> This insurance does not apply to:
> a. "Bodily injury", "property damage" or "personal and advertising injury" arising out of any:
> (1) Alleged assault or battery; or
> (2) Act or omission in connection with the prevention or suppression of such acts, including the alleged failure to provide adequate security,
> b. Claims, accusations, or charges of negligent hiring, placement, training or supervision arising from actual or alleged assault or battery.[372]

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which insured attacked neighbor in belief that neighbor was threatening insured's father, insurer was not obligated to defend insured against neighbor's negligence claim based on insured's failure to correctly assess situation and failure to prevent and/or not participate in a physical altercation; claim was merely attempt to characterize intentional acts as negligence).

[368] 396 F. Supp. 2d. 624 (D. Md. 2005) (bar patrons' negligence claims against bar owner and bouncers were not covered where negligence count was based upon allegation of intentional acts).

[369] 215 F. Supp. 2d 656 (D. Md. 2002) (claims against insured motel owner were within CGL policy's assault and battery exclusion regardless of negligence count, where claims unquestionably arose out of alleged "omission in connection with the prevention or suppression of an assault or battery" which was expressly excluded).

[370] 88 F. Supp. 2d 424 (D. Md. 2000) (there was no potentiality of coverage for claims against insured for negligent hiring and failure to provide security where policy excluded claims "arising out of an act or omission in connection with the prevention of an assault or battery").

[371] 1992 WL 138352 (Civ. A. No. HAR 9101769, D. Md. June 3, 1992) (coverage for claims of negligent failure to prevent assault and battery was not available where exclusion provided that "no coverage shall apply under this policy for any claim, demand or suit based on 'assault and battery'").

[372] Nautilus Insurance Company form S138 (01/04).

Notably, this exclusion applies to claims arising out of *alleged* assault or claims of *negligent hiring, placement, training or supervision* arising from *actual or alleged* assault or battery. This exclusion is designed to make clear that the insurer offers no coverage in connection with claims arising out of alleged assault and battery, even if they ultimately are not proven.[373]

b. Sexual Assault Against Minors

Where an insured is sued for sexual assault on a minor, the insured frequently seeks to evade the intentional injury exclusion by alleging that he lacked the subjective intent to cause either the specific injury that the tort plaintiff alleges or any injury at all. The Court of Special Appeals faced such a case in *Harpy v. Nationwide Mut. Fire Ins. Co.*[374] There, the insured was sued for sexually assaulting his daughter from the time she was nine to thirteen years old. The insured alleged he neither "intended [n]or expected that she would suffer *the type of injuries* that she . . . alleged in her Complaint. . . ."[375] The insured argued that although he intended the acts, he did not have the subjective intent to cause the injuries which actually resulted.[376] In *Harpy*, the Court held that intent to injure would be inferred as a matter of law in cases involving sexual assault against minors.[377] This decision was reaffirmed in *Pettit v. Erie Ins. Exch.*,[378] in which the Court reasoned that the insured's sexual molestation constituted common law battery and the mere intent to touch was a tort. Thus, there should be no duty to defend or indemnify in such cases.[379]

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[373] *See also Boxley* and *GLM, supra* (excluding coverage for claims "arising out of an act or omission in connection with the prevention of an assault or battery"); *Sphere Drake, supra* (excluding coverage for "any claim, demand or suit based on assault and battery").

[374] 76 Md. App. 474, 545 A.2d 718 (1988).

[375] *Id*. at 477, 545 A.2d at 720 (emphasis in original).

[376] *Id*. at 482, 545 A.2d at 722. This argument was accepted in *State Auto Mut. Ins. v. McIntyre*, 652 F. Supp. 1177 (N.D. Ala. 1987), where the Court considered the insured's denial of intent to harm and concluded that the insured had no intent to harm when he sexually fondled his granddaughter. *Compare Allstate v. Sparks, supra*.

[377] *Harpy*, 76 Md. App. at 486, 545 A.2d at 724. *See also Allstate v. Atwood*, 319 Md. 247, 253-54, 572 A.2d 154, 157-58 (1990); *Whitt v. DeLeu*, 707 F. Supp. 1011 (W.D. Wis. 1989) (noting that 14 of 15 courts which have considered the issue found intent to injure as a matter of law in liability insurance cases involving alleged sexual misconduct against minors).

[378] 349 Md. 777, 709 A.2d 1287 (1998).

[379] *Id*. at 786, 709 A.2d at 1291-92. For number of occurrences in sexual molestation cases, see, e.g., *H.E. Butt Grocery Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 150 F. 3d 526 (5th Cir. 1998) (independent acts of abuse of two children constituted two occurrences); *Lee v. Interstate Fire & Cas. Co.*, 86 F.3d 101 (7th Cir. 1996) (concluding that question was issue of fact); *Soc. of the Roman Catholic Church of the Diocese of Lafayette and*

Some policies have specific sexual molestation exclusions, such as the following:

ABUSE OR MOLESTATION EXCLUSION
The following exclusion is added to Paragraph 2. Exclusions of Section I – Coverage A – Bodily Injury and Property Damage Liability:
This insurance does not apply to "bodily injury", "property damage" or "personal and advertising injury" arising out of:

1. The actual or threatened abuse or molestation by anyone of any person while in the care, custody or control of any insured, or
2. The negligent:
   a. Employment;
   b. Investigation;
   c. Supervision;
   d. Reporting to the proper authorities, or failure to so report; or
   e. Retention;

   of a person for whom any insured is or ever was legally responsible and whose conduct would be excluded by Paragraph 1. above.[380]

Such exclusions have been for the most part upheld.[381]

Lake Charles, Inc. v. Interstate Fire & Cas. Co., 26 F.3d 1359 (5th Cir. 1994) (where 31 children alleged abuse by priests, damage to each child was a separate occurrence, and each child suffered an occurrence in each policy period in which that child was molested).

[380] ISO Form CG 21 46 0798.

[381] *See Hingham Mut. Fire Ins. Co. v. Smith*, 2007 WL 1345966 (Mass. App. 2007) (sexual molestation exclusion barred coverage for negligent supervision claims arising out of sexual molestation by policyholder's son); *Nautilus Ins. Co. v. Our Camp, Inc*. 136 Fed. Appx. 134 (10th Cir. 2005) (Wyo. law) (excluded coverage for negligent training and supervision of camp counselors, negligent supervision of campers, and negligent failure to disclose alleged molestation); *Concord General Mut. Ins. Co. v. Madore*, 882 A.2d 1152, 1155 (Vt. 2005) (exclusion upheld); *Farmer ex rel. Hansen v. Allstate Ins. Co*., 2004 WL 727698 (C.D. Cal. 2004) (exclusion barred coverage for home day care business where husband of insured allegedly molested child); *New London County Mut. Ins. v. Riddick*, 2004 WL 2284207 (Conn. Super.) (exclusion enforced); *Ristine ex rel. Ristine v. Hartford Ins. Co. of Midwest*, 195 Or. App. 226 (2004) (exclusion for bodily injury claims "[a]rising out of sexual molestation" applied to negligence claim by mother of alleged sexual abuse victim against wife of alleged molester, which alleged that wife was negligent in failing to disclose that husband was convicted sex offender and that wife recklessly inflicted emotional distress in allowing victim to spend night in their home); *S.C. Farm Bureau* Mut. Ins. Co. v. Oates, 588 S.E.2d 643, 646 (S.C. App. 2003) (exclusion upheld); *Am. Nat'l. Gen. Ins. Co. v. L.T. Jackson*, 203 F. Supp. 2d 674 (S.D. Miss. 2001) (sexual molestation exclusion applied to sexual discrimination under Fair Housing Act where all of the owner and manager's alleged conduct constituted or arose from acts of sexual molestation); *Northland Ins. Co. v. Briones*, 97 Cal. Rptr.2d 127 (Cal. App. 2000) (sexual molestation exclusion precluded coverage for alleged acts of stalking, assaulting and raping student, as well as possibly negligent acts of causing relationship to "become far more intense than that of teacher-student" and interfering with familial relationship); *Sanchez v. Callegan*, 753 So.2d 403 (La. App. 2000) (sexual molestation exclusion applied to negligence claim against spouse of alleged abuser); *Community Action For Greater Middlesex County, Inc. v. Am. Alliance Ins. Co*.,

c. Self-Defense

Courts differ as to whether the intentional injury exclusion applies where the insured intentionally injures another while acting in self-defense. Under the 1973 ISO policy, there is no specific exception from the intentional injury exclusion for those injuries which are committed under a privilege. Coverage for self-defense is problematic under the 1973 intentional injury exclusion. Some courts reason that where the insured intended the act of striking or shooting his assailant, the harm is intended. In *Western World Ins. v. Hartford Mut. Ins. Co.*,[382] a police officer shot at a fleeing felon and the Fourth Circuit affirmed the District Court's finding that the "bodily injury" was intentional, even if done in self-defense. On the other hand, in *Allstate Ins. Co. v. Atwood*,[383] the Court of Appeals of Maryland implied that self-defense may be an exception to the intentional act exclusion. The opinion refers to *Transamerica Ins. Group v. Meere*[384] to determine when "intent to injure may be inferred as a matter of law."[385]

Meere arose out of a fight outside a bar between a former police officer and an off-duty prison guard and involved the application of a homeowner's policy. The *Meere* Court framed the issue as "whether the conduct which led to the blow was intentionally wrongful from the viewpoint of the law of torts."[386] The Court held that where the:

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757 A.2d 1074 (Conn. 2000) (fondling of six-year-old girl's vagina by boys was within the exclusion); *Northwest G.F. Mut. Ins. Co. v. Norgard*, 518 N.W.2d 179 (N.D. 1994) (sexual molestation exclusion in home day care endorsement barred coverage for both husband and wife for husband's alleged molestation of child); *United Nat'l Ins. Co. v. Entertainment Group, Inc.*, 945 F.2d 210 (7th Cir.1991) (Illinois law) (sexual molestation exclusion applied to suit alleging negligence in failure to prevent sexual assault although suit did not allege sexual molestation by the insured); *United Nat'l Ins. Co. v. Waterfront New York Realty Corp.*, 994 F.2d 105 (2d Cir. 1993) (sexual molestation exclusion was not ambiguous for overlapping with assault and battery clause as both excluded claims for sexual assault and battery against persons under 16 years old, and sexual molestation clause also excluded claims arising out of wrongful sexual acts that were not assaults or batteries, such as statutory rape); *cf. Am. Family Mut. Ins. Co. v. Enright*, 781 N.E.2d 394 (Ill. App. 2002) (exclusion did not apply to negligent hiring claim); *Newby v. Jefferson Parish School Bd.*, 738 So.2d 93 (La. App. 1999) (consensual sexual intercourse between 14-year-old girl and 17-year-old insured that continued after girl turned 18 was not "sexual molestation"); *Sentry Ins. Co. v. Miller*, 914 F. Supp. 496 (M.D. Ala. 1996) (sexual molestation exclusion did not bar coverage for negligence claim that insured permitted 5-year-old-girl's hand to be placed on his penis).

[382] 600 F. Supp. 313, 318-21 (D. Md. 1984), *aff'd in part and rev'd in part*, 784 F.2d 558, 562-63 (4th Cir. 1986).

[383] 319 Md. 247, 254, 572 A.2d 154, 157 (1990).

[384] 694 P.2d 181, 189-90 (Ariz. 1984).

[385] *Atwood*, 319 Md. at 254, 572 A.2d at 157-58.

[386] *Meere*, 694 P.2d at 189.

> trier of fact determines that [the insured] was the aggressor and acted wrongfully by striking [the victim] without legal justification, the basic intent to injure will be presumed and the exclusion will apply . . . . If the finder of fact determines that [the insured's] conduct was not intentionally wrongful, but that he acted instead in self-defense with no basic purpose to injure, the exclusion will not apply. . . . If the jury finds that [the insured] acted in self-defense with no basic desire or intent to harm [the victim] but negligently used force greater than necessary in self-defense [the insured] may be liable . . . [and it is] within the coverage of the policy and not within the exclusion.[387]

If the Court of Appeals adopts the *Meere* test as applied to the 1973 policy in assault and battery cases, then there will be a duty to defend in most such cases. Under the *Meere* test, intent to injure may be inferred as a matter of law only where the assault is unprovoked and unprivileged.[388] Whether Maryland will adopt this rule is unclear, but it is mostly of historical interest. The 1986 ISO policy intentional injury exclusion has a specific exception for self-defense, as follows:

> This insurance does not apply to:
>
> a. "Bodily injury" or "property damage" expected or intended from the standpoint of the insured. This exclusion *does not apply to "bodily injury" resulting from the use of reasonable force to protect persons or property*.[389]

This exclusion was applied in *Aetna Cas. & Sur. Co. v. Cochran.*[390] There, the Court of Appeals of Maryland modified the exclusive pleading rule and held that the CGL insurer, Aetna, had a duty to defend an action alleging solely intentional torts, where the insured had presented evidence that he acted in self-defense.[391]

Aetna had issued a CGL which contained the standard intentional injury exclusion.

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[387] *Id.* at 189-90.

[388] *Id*. at 187-88.

[389] (emphasis added). *See Aetna Cas. & Sur. Co. v. Cochran*, 337 Md. 98, 651 A.2d 859 (1995).

[390] *Id.* at 112, 651 A.2d at 866.

[391] *Id.* at 110-11, 651 A.2d at 865-66.

The underlying complaint alleged assault, battery, and loss of consortium and it contained no hint that the plaintiff's bodily injury resulted from the insured's use of reasonable force to protect himself, which would potentially bring the alleged acts within the exception to the exclusion.[392] The Court held that although an insurer may not rely on extrinsic evidence to avoid a duty to defend, an insured may raise a duty to defend by relying on extrinsic evidence. [393] This serves one of the purposes of the policy in providing "litigation insurance," so that the insured is protected "from the expense of defending suits brought against him."[394] Otherwise, the insured must rely on a plaintiff to file a well-pleaded complaint in order to establish a potentiality for coverage.

Proving a duty to defend in an assault and battery case is particularly problematic if the insured is limited to the allegations of the complaint. But, while the insured is permitted to rely on sources other than the complaint, the insured cannot assert a frivolous defense merely to establish a duty to defend on the part of the insurer. Raising self-defense as an affirmative defense alone is insufficient to raise a duty to defend. The insured must demonstrate that there is a reasonable potential that the asserted defense will be relied upon at trial. Note that the exception to the exclusion applies where "reasonable" force is used in self-defense. Hence, where force greater than necessary is used in self-defense, there should be no duty to indemnify.[395]

d. Mistakes

Some courts draw a distinction between intentional acts and "mistakes."[396] Sometimes the insured clearly intended the act and the injury, but not to the actual victim. The courts reach varying results in "mistake" cases.[397]

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[392] *Id*. at 105, 651 A.2d at 862-63.

[393] *Id.*

[394] *Id*. at 110, 651 A.2d at 865 (quoting *Brohawn*, 276 Md. at 410, 347 A.2d at 851).

[395] *Cf. Transamerica Ins. Group v. Meere*, 694 P.2d 181, 189-90 (Ariz. 1984). *See generally* James L. Rigelhaupt, Jr., Annotation, *Acts In Self-Defense As Within Provision of Liability Insurance Policy Expressly Excluding Coverage for Damage or Injury Intended or Expected by Insured,* 34 ALR 4th 761 (1984).

[396] The leading case in Maryland is *Haynes v. Am. Cas. Co.* 228 Md. 394, 179 A.2d 900 (1962) (damage caused by insured contractor's employees who, contrary to contractor's directions, cut trees beyond property line was "caused by accident" within CGL policy, even though cutting of trees was intentional act of employees). The leading case in Virginia is *Parker v. Hartford Fire Ins. Co.*, 278 S.E.2d 803 (Va. 1981) (liability insurer had duty to defend insureds in action for alleged desecration of and trespass on family burial ground where pleadings could have supported judgment of unintentional trespass).

[397] *See, e.g., Am. Family Mut. Ins. Co. v. Mission Medical Group*, 72 F.3d 645 (8th Cir. 1995) (teenager who mistakenly

A leading case is *Red Ball Leasing, Inc. v. Hartford Accident and Indem.,*[398] in which the Court concluded that a mistake is not an accident. There, Red Ball wrongfully repossessed four trucks because of an accounting system error which indicated that the owner was in default on his truck payments. The owner sued Red Ball for "intentional and negligent conversion of the trucks, breach of contract, intentional interference with business, and conspiracy to interfere with business."[399] Hartford refused to defend and Red Ball sued, alleging breach of the insurance contract.

The trial court held that the owner's suit did not allege an occurrence because the injury was "the natural result of the voluntary and intentional act of repossession."[400] On appeal, the Seventh Circuit agreed, reasoning that:

> "[a] volitional act does not become an accident simply because the insured's negligence prompted the act. Injury that is caused directly by negligence must be distinguished from injury that is caused by a deliberate and contemplated act initiated at least in part by the actor's negligence at some earlier point. The former injury may be an accident…. However, the latter injury, because it is intended and the negligence is attenuated from the volitional act, is not an accident.[401]

The Court held that while Red Ball may have honestly believed that it had a legal right to repossess the trucks, "the decision to take the trucks--an intentional act of Red Ball--[was] not an 'accident' under the terms of the insurance policy."[402] Numerous other courts have followed this reasoning.[403]

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burned down wrong building, which he thought was abortion clinic, could not avoid exclusion); *State Farm Fire & Cas. v. Martin*, 660 A.2d 66 (Pa. Super. 1995) (drunken insured not covered because he meant to hit someone else); *Sabri v. State Farm Fire and Cas. Co.*, 488 So. 2d 362 (La. App. 1984) (policy provided coverage for incident in which insured mistakenly shot his daughter; although insured's firing of gun was intentional, injury to daughter was not); *Curtain v. Aldrich*, 589 S.W.2d 61 (Mo. App. 1979) (holding that where the insured beat his brother-in-law over the head with a crowbar after mistaking him for a burglar, the intentional injury exclusion was not applicable).

[398] 915 F. 2d 306 (7th Cir. 1990).

[399] 915 F.2d at 308.

[400] *Id.*

[401] *Id*. at 311.

[402] *Id*. at 312.

[403] *See, e.g., Prodent, Inc. v. Zurich U.S.*, 33 Fed. Appx. 32, 2002 WL 480965 (3d Cir. Mar. 29, 2002) (where the

e. False Arrest, Malicious Prosecution and Defamation

False arrest, malicious prosecution and defamation are covered in the 1986 ISO policy under Coverage B Advertising Injury and Personal Injury Coverage.[404] The 1973 ISO policy was not designed to include these coverages, but they were available by endorsement. But what about coverage under the "Bodily Injury and Property Damage" provision? Defamation may be negligent as well as intentional.[405]

In a case applying the 1973 ISO policy, *S. Md. Agric. Ass'n v. Bituminous Cas. Corp.*,[406] the plaintiffs in the underlying tort suit alleged that the insureds made improper charges of theft, resulting in their indictment, which was *nolle prosequi*. The action sounded in malicious interference with contract, malicious prosecution, and intentional

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policyholder negligently installed copper pipe instead of PVC as called for by the drawings, it was not an occurrence); *Mass. Bay Ins. Co. v. VIC Koenig Leasing, Inc.*, 136 F.3d 1116 (7th Cir. 1998) (Tenn. law) (improper repossession is not an occurrence and is excluded by the "expected and intended injury" exclusion); *New Hampshire Ball Bearings v. Aetna Cas. & Sur. Co.*, 43 F.3d 749 (1st Cir. 1995) (the Court found it impossible to conclude that the policyholder intended the dumping but not the groundwater contamination); *Fidelity & Guar. Ins. Underwriters, Inc. v Brown*, 25 F. 3d 484 (7th Cir. 1994) (insured's intentional conduct in terminating employee and refusing to issue to employee a converted policy of health insurance was not an accident or occurrence); *Thomason v. United States Fidelity & Guar. Co.*, 248 F.2d 417, 419 (5th Cir. 1957) (not an accident when bulldozer operator made mistake about location of boundary for land to be cleared); *Macon Iron & Paper Stock Co., Inc. v. Transcontinental Ins. Co.*, 93 F. Supp. 2d 1370 (M.D. Ga. 1999) (policyholder's mistaken scrapping of railcars that belonged to a third party was not an accident where it intended the acts but claimed they were negligently prompted by erroneous information); *Argonaut v. Maupin*, 500 S. W. 2d 633 (Tex. 1973). In *Argonaut*, the policyholder removed dirt from certain premises having received permission to do so from someone who did not have authority to grant such permission. The owners of the property brought an action in trespass. The Texas Supreme Court held that the removal of dirt was intentional and deliberate, remarking that the tortfeasor accomplished exactly what he intended to accomplish. The fact that the defendant did not deal with the owner was due to a mistake or error. That mistake did not negate the intentional nature and deliberateness of the act. *See also Foxley & Co. v. USF&G*, 277 N. W. 2d 686 (Neb. 1979) (where injury for which recovery was sought from insured resulted from mistake of law on the part of insured, there was no accident within meaning of policy); *Pfeiffer, III v. Grocers Mut. Ins. Co.*, 379 A. 2d 118, 124 (Pa. Super. 1977) (dicta) (recognizing that some courts find a contractor's trespass accidental and some do not); *Haynes v. Am. Cas. Co.*, 228 Md. 394, 179 A.2d 900 (1962) (finding that loss was accidental where contractor pointed out a property line to his employees, left the site, and returned, finding that employees had encroached on adjacent property and cut down 48 trees).

[404] These coverages are beyond the scope of this manual.

[405] *See, e.g., Fuisz v. Selective Ins. Co. of Am.*, 61 F.3d 238, 244 n.3 (4th Cir. 1995) (Va. law); *but see Gordon v. Hartford Fire Ins. Co.*, 105 Fed. Appx. 476, 2004 WL 1637637 (No. 03-2411, 4th Cir. July 23, 2004) (although complaint against insured mentioned negligence and general misrepresentations without characterizing them as intentional, the substance of the claims against the insured was intentional misconduct, including conspiracy, defamation, and harassment.; thus, claims fell within intentional acts exclusion).

[406] 539 F. Supp. 1295 (D. Md. 1982).

infliction of emotional distress.[407] The insureds brought a declaratory judgment action against Bituminous Casualty Corp. and Fireman's Fund Insurance Co. concerning coverage under their respective insurance policies.

The Court analyzed Bituminous' policy first. The Court held that none of the allegations of the complaint could reasonably be said to have been due to an "accident."[408] Even if they arose out of "continuous and repeated exposure to conditions," they could not be said to have been "unexpected" by the plaintiffs and were not "accidental" in nature.[409]

The Court then construed the Fireman's Fund policy, which contained no definition of the word "occurrence."[410] In the 1973 policy, the intentional injury exclusion was contained in the definition of occurrence. Without the exclusion, there was no contractual reason to except coverage for false arrest, malicious prosecution and defamation. Thus, the Court held the term "occurrence" to be ambiguous, despite the complaint's allegation of intentional injury.[411] However, other courts have held that the common law actual malice standard of defamation does not equate to intentional injury.[412]

The defamation problem is solved in the 1998 ISO revision,[413] which adds exclusion "o" to Coverage A for "bodily injury arising out of personal and advertising injury." This excludes from Coverage A claims for defamation that more properly belong in Coverage B.

f. Mental Incapacity

Some courts have held that "mental incapacity" may negate intent to injure. This

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[407] None of the alleged offenses are "personal injuries" as defined by the policy.

[408] 539 F. Supp. at 1300.

[409] *Id.* The Court cited *St. Paul Fire & Marine Ins. Co. v. Pryseski*, 292 Md. 187, 438 A.2d 282 (1981), where the policy also did not contain a definition of "occurrence."

[410] *Southern Md. Agric. Ass'n*, 539 F. Supp. at 1306.

[411] *Id.* at 1306. *See also Ed. Winkler & Son, Inc. v. Ohio Cas. Ins. Co.*, 51 Md. App. 190, 441 A.2d 1129 (1982), discussed *supra*, involving an action for false arrest, malicious prosecution, and slander.

[412] *See, e.g., Fuisz v. Selective Ins. Co. of Am.*, 61 F.3d 238, 245 (4th Cir. 1995) (Va. law).

[413] For a complete copy of the 1998 version of the CGL policy, see Appendix C.

issue may arise where the insured was intoxicated, insane or suffering from epilepsy or another physically altered mental state.[414] A person suffering from a mental disease may intend harm in two respects: as a consequence of that disease or unrelated to the disease. Moreover, even where an insane person intends a result because of a delusion, this is qualitatively different from a person suffering from an epileptic seizure, where his movements are involuntary.[415] Finally, some courts hold that children of tender years do not have the capacity to commit intentional acts.[416]

In *Erie Ins. Exchange v. Stark*,[417] the insured set fire to his house, allegedly to commit suicide by self-immolation. The Fourth Circuit, applying Maryland law, held that his suicidal purpose did not necessarily defeat the defense of intentional act.[418] The Court was analyzing a homeowner's policy which had an "increase in hazard, neglect and intentional loss clause." The Court summarized the Maryland decisions as holding that a "lack of capacity to act 'intentionally' could only be found in two forms of 'insanity.' The first is a delusional form, in which the actor simply does not even understand the physical consequences of an act. . . . The other is an 'insane impulse' form in which the actor is unable to resist doing the act in issue, i.e., lacks volitional capacity."[419]

In *Lititz Mut. Ins. Co. v. Bell*,[420] the Court of Appeals, relying on *Pettit*, *supra*, held that when an insured admits to intentionally striking someone, but claims that a mental (impulse-control) disorder kept him from intending to cause harm, the insured's conduct

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[414] *See generally* James L. Rigelhaupt, Jr., Annotation, *Liability Insurance: Intoxication or Other Mental Incapacity Avoiding Application of Clause in Liability Policy Specifically Exempting Coverage of Injury or Damage Caused Intentionally by or at Direction of Insured*, 33 ALR 4th 983 (1984).

[415] *See, e.g., Rajspic v. Nationwide Mut. Ins. Co.*, 662 P.2d 534 (Idaho 1983).

[416] *See, e.g., Connecticut Indem. Co. v. Nestor*, 145 N.W.2d 399 (Mich. App. 1966) (8 ½-year-old who set fire to a residence did not intend damage to house); *INA v. Shore*, 404 N.Y.S.2d 807 (Sup. Ct. 1978) (6-year-old did not intentionally commit assault on another child).

[417] 962 F.2d 349 (4th Cir. 1992) (applying Maryland law).

[418] *Id*. at 356.

[419] *Id*. at 356 (citing *Reinking v. Philadelphia Am. Life Ins. Co.*, 910 F.2d 1210, 1215 (4th Cir. 1990)). *See also Ins. Co. of N. Am. v. Aufenkamp*, 291 Md. 495, 435 A.2d 774 (1981) (involving a "personal accident and special hazards insurance" policy and suicide exclusion); *Globe Am. Cas. v. Lyons*, 641 P.2d 251 (Ariz. App. 1981) (finding that an insured who drove her car directly into a pickup truck in an attempted suicide in response to "auditory hallucinations that overcame her ability to act rationally did not intend to cause bodily injury or property damage").

[420] 352 Md. 782, 724 A.2d 102 (1999). There, the tortfeasor was insured under a homeowner's policy of insurance.

still falls within the intentional injury exclusion, because the touching is the harm. The Court reasoned that:

> If [the insured] had not intended the contact itself due to a mental condition, then the act might be considered an "accident" and not intentional because the contact (the harm) would have taken place without his foresight or expectation. However, where the actor intends to cause an offensive contact, the legally recognized harm, *ipso facto*, cannot be said to have taken place without his foresight or expectation.[421]

The Court in *Lititz* also relied upon *Saba v. Darling*,[422] which involved a fight outside a bar involving an intoxicated insured. There, the Court found that

> where the insured "intentionally hit [the tort plaintiff] causing injury to his jaw. . . [s]uch an event is the *sine qua non* of an intentional tort…. Although [the defendant] testified that he did not intend to break [the plaintiff's] jaw, obviously he intended to strike [the plaintiff] and the severity of the injury is of no consequence in an analysis of [the defendant's] state of mind."[423] The insured was not so intoxicated as to be unable to formulate the intent to strike the tort plaintiff.[424]

g. Innocent Co-Insureds

Innocent co-insureds are frequently sued for failing to provide sufficient security or otherwise protect the plaintiff. In those cases, coverage should turn on whether the policy excludes "the" insured, "any" insured, or "an" insured. If only "the insured" is excluded, then there should be coverage, because the severability of interests clause will mandate that each insured's coverage be analyzed separately.[425] The Court of Appeals of Maryland has held that "an insured" should be read the same way.[426] The standard CGL

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[421] *Id*. at 798, 724 A.2d at 110.

[422] 320 Md. 45, 575 A.2d 1240 (1990), *aff'd,* 72 Md. App. 487, 531 A.2d 696 (1987).

[423] 320 Md. at 49, 575 A.2d at 1242.

[424] *Id.*

[425] *See, e.g., Hanover Ins. Co. v. Ngoclien Thi Crocker*, 688 A.2d 928 (Me. 1997).

[426] *See Litz v. State Farm*, 346 Md. 217, 228-30, 695 A.2d 566, 571-72 (1997). This seems to be a non-grammatical interpretation.

excludes “the insured” so usually the co-insured should not be excluded. If “any” insured is excluded then it should act as a bar to any claim.[427]

B. CONTRACTUAL LIABILITY EXCLUSION

A clause allocating risk is a standard provision in many contracts. Insureds frequently have no choice but to agree to indemnify others if they wish to enter into a contract. As a result, the ISO added a contractual liability exclusion intended to avoid coverage for liability specifically contracted for by the insured.

Without a contractual liability exclusion, the insurer would be liable for all assumptions of liability by the insured. When the ISO’s 1973 CGL was drafted, insurers determined that they did not wish to cover this additional risk without an additional premium. Therefore, all but "incidental contracts" were excluded from coverage. Extended coverage could be purchased separately for those insureds who needed this protection. In the 1986 ISO CGL the extended coverage is incorporated into the basic form.

The purpose of the contractual liability exclusion is to limit the coverage to the insured's tort liability. The CGL insurer does not intend to underwrite the insured's contractual undertakings, nor is a general liability policy a performance bond.[428]

1. The 1973 Provision

The 1973 ISO policy provided in pertinent part:

This insurance does not apply:

(a) to liability assumed by the insured under any contract or agreement except an incidental contract but this exclusion does not apply to a warranty of fitness or quality of the named insured's products or a warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner;

“Incidental contract” is defined by the policy as:

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[427] *See, e.g., Amick v. State Farm Fire & Cas. Co.*, 862 F.2d 704, 706 (8th Cir. 1988); *McAllister v. Millville Mut. Ins. Co.*, 640 A.2d 1283, 1289 (Pa. Super. 1984).

[428] *Reliance Ins. Co. v. Mogavero*, 640 F. Supp. 84, 85 (D. Md. 1986).

> any written (1) lease of premises, (2) easement agreement, except in connection with construction or demolition operations on or adjacent to a railroad, (3) undertaking to indemnify a municipality required by municipal ordinance, except in connection with work for the municipality, (4) sidetrack agreement, or (5) elevator maintenance agreement.

The scope of the contractual liability exclusion is limited as to tort liability. The exclusion eliminates only liability "assumed by contract." If the insured would be liable to the third party based on its own negligence, then the exclusion does not relieve the insurer of liability. A frequently given example is where an electrical subcontractor negligently installs electrical switches, causing a fire to destroy a building. The contractual liability exclusion does not operate to bar coverage under an indemnity agreement between the electrical contractor and the general contractor because the subcontractor would be liable at common law.[429] Hence, if the insured/indemnitor would be liable to the indemnitee absent the contract provision, the exclusion does not bar coverage.

Coverage for contractual liability in the 1973 ISO policy is quite limited. It excludes coverage for liability assumed by the insured under any contract or agreement unless that contract or agreement is an "incidental contract." The exceptions to the exclusion appear primarily in the definition of incidental contracts. They are quite specific and, for the most part, self-explanatory.

A further exception appears in the body of the exclusion. It provides that it "does not apply to a warranty of fitness or quality of the named insured's products or a warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner." This exception has been interpreted by some courts as a separate grant of coverage. Those courts find that the "warranty" exception when read in conjunction with the product and workmanship exclusions results in an ambiguity nullifying the effect of those exclusions.[430] Maryland has *rejected* that analysis.[431]

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[429] *See generally* 7A J. Appleman § 4493 (Berdal ed. 1979 & 2003 Cum. Supp.); 9 *Couch on Insurance 3d* § 129:30 (3d ed. 2003); C.T. Drechsler, Annotation, *Scope and Effect of Clause in Liability Policy Excluding From Coverage Liability Assumed by Insured Under Contract Not Defined in Policy, Such as One of Indemnity*, 63 A.L.R. 2d 1122 (1959). *Cf. Continental Cas. Co. v. Anne Arundel Cmty. College*, 867 F.2d 800, 803-04 (4th Cir. 1989).

[430] *See, e.g., Baybutt Constr. Corp. v. Commercial Union Ins. Co.*, 455 A.2d 914, 921-22 (Me. 1983); *Commercial Union Assur. Cos. v. Gollan*, 394 A.2d 839 (N. H. 1978).

[431] *See Century I Joint Venture v. USF&G*, 63 Md. App. 545, 558-60, 493 A.2d 370, 377-78, *cert. denied*, 304 Md. 297 (1985); *Harbor Court Assocs. v. Kiewit Constr. Co.*, 6 F. Supp. 2d 449, 458 n.21 (D. Md. 1998); *Mogavero*, 640 F. Supp. at 87 n.3.

2. Extended Coverage

Extended coverage for the 1973 provision was available through the "contractual liability coverage," which extended coverage by changing the definition of "incidental contract" to include "any contract or agreement relating to the conduct of the named insured's business." If purchased as part of the BFCGL Endorsement or as the Contractual Liability Insurance Endorsement, it reads: "All sums which the insured, by reason of contractual liability assumed by him under any written contract of the type designated in the schedule of this insurance, shall become legally obligated to pay as damages because of bodily injury or property damage . . . ."

3. The 1986 Policy

The Commercial General Liability contractual liability exclusion provides:

This insurance does not apply to:

b. "Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

(1) Assumed in a contract or agreement that is an "insured contract"; or

(2) That the insured would have in the absence of the contract or agreement.

Insured Contract Definition

6. "Insured contract" means:
   a. A lease of premises;
   b. A sidetrack agreement;
   c. An easement or license agreement in connection with vehicle or pedestrian private railroad crossings at grade;
   d. Any other easement agreement except in connection with construction or demolition operations on or within 50 feet of railroad;
   e. An indemnification of a municipality as required by ordinance,

except in connection with work for a municipality;
f. An elevator maintenance agreement; or
g. That part of any other contract or agreement pertaining to your business under which you assume the tort liability of another to pay damages because of "bodily injury" or "property damage" to a third person or organization, if the contract or agreement is made prior to the "bodily injury" or "property damage." Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

The 1986 ISO Policy contains contractual liability coverage as part of the standard package. This exclusion is designed to eliminate contractual liability coverage with two exceptions: (1) "insured contracts" and (2) liability the insured would have absent an agreement. "Insured contracts" may be oral; they need not be in writing. Part (2) of the exclusion removes liability "that the insured would have in the absence of the contract or agreement" from the scope of the agreement, to make coverage certain in those situations. Therefore, if the insured would have been liable in the absence of the contract, e.g., where the insured's own negligence caused the accident, the insured will be covered. The 1986 ISO form includes as "insured contracts" all business agreements to assume the *tort* liability of another.

The definition of "insured contract" is similar to the extended coverage definition of "incidental contract" in the 1976 ISO Broad Form Endorsement. One significant difference is that the Broad Form Endorsement expanded the coverage of "incidental contract" to include "any contract or agreement relating to the conduct of the named insured's business." One other difference is that the new provision excludes any mention of warranties. Further, the liability of architects, engineers and surveyors is not covered.

Where the "indemnity" contract simply apportions damages between the indemnitee and the plaintiff's employer, it may not be an "indemnity agreement" and thus not an "insured contract.[432]

In 1998 the exclusion was amended to read, in pertinent part:

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[432] *See* Merriman and Cohen, *When is an Indemnity Agreement Not an Insured Contract?* , The Voice, February 21, 2007. *See, e.g., Lubrizol Corp. v. Nat'l Union Fire Ins. Co.,* 200 Fed. Appx. 555, 2006 WL 2986396 (No. 05-3280, 6th Cir. Oct. 17, 2006) (indemnity agreement was not "insured contract" under plain language of umbrella policy)*; Va. Sur. Co. Inc. v. N. Ins. Co. of N. Y.*, 866 N.E. 2d 149 (2007) (subcontractor's agreement to indemnify and hold harmless general contractor was not "insured contract" under CGL policy).

This exclusion does not apply to liability for damages:
* * *
(2) Assumed in a contract or agreement that is an "insured contract", provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. *Solely for the purposes of liability assumed in an "insured contract", reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of "bodily injury" or "property damage", provided:*
(a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and
(b) Such attorney fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.
(emphasis added).

4. Defense Costs

Frequently, indemnity agreements provide that the insured shall provide a defense for the indemnitee. Although the indemnity cost and legal fees may be covered by the indemnitor's contractual liability coverage, the insurer does not have an *obligation* to defend the indemnitee -- only a duty to defend the indemnitor (the insured). The duty to defend is governed by the contract, which does not require the insurer to defend anyone except an insured.[433] This is cold comfort to the insurer, as it may ultimately be responsible for any liability of the insured, including attorneys' fees, because of the insured's failure to defend the indemnitee.[434]

The 1998 edition of the ISO CGL was amended to provide that reasonable attorneys' fees were covered if the insured assumes liability under an "insured contract."

5. Breach of Contract Distinguished

What happens if the insured contracts to add another party as an additional insured under the policy but fails to do so? It is important to distinguish between the insured's

[433] *Hartford Ins. Group v. Royal Globe Co.*, 517 P.2d 1117 (Ariz. App. 1974); *Jefferson v. Sinclair Ref. Co*., 179 N.E. 2d 706 (N.Y. 1961).

[434] *Williams v. Cal. Co.*, 289 F. Supp. 376 (E. D. La. 1968); *Hartford Ins. Group v. Royal Globe Co.*, 517 P.2d 1117 (Ariz. App. 1974); 7A J. Appleman, *Insurance Law and Practice*, § 4497.02 n. 5 (1979).

liability to assume the liability of another and the insured's breach of contract. Insurance does not cover the liabilities of the insured for breach of contract. It may, however, cover the contractual assumption of liability of another for "property damage" or "bodily injury."

For example, in *Pyles v. Pa. Mfrs.*,[435] Pilli contracted with Pyles to build a house and *orally* agreed to maintain $750,000 of builder's risk insurance on the house during construction.[436] Pilli purchased only $250,000.[437] Thereafter, the house burned down.[438] Pyles sued Pilli in contract and in tort for failure to obtain the agreed insurance.[439] Pilli requested a defense from Pennsylvania Manufacturers Association Insurance Co. ("PMA") pursuant to his general liability and umbrella policies; PMA denied coverage.[440] Judgment was entered against Pilli in excess of the builder's risk policy and Pilli assigned his claim against PMA to Pyles.[441] Both policies promised to pay for "property damage . . . caused by an 'occurrence.'" The trial court held that the policies required a nexus between the insured's liability and the accidental property damage.[442] The Court affirmed the trial court judgment, noting that Pilli's liability was not a "direct result of *property damage*," rather it was "a direct result of [Pilli's] negligence and breach of contract in failing to obtain the agreed upon amount of builder's risk insurance on the house."[443] Because no nexus existed, there was no coverage.[444]

In *Pyles*, the insured breached its contract to make Pilli an additional insured. This situation must be distinguished from those in which the insured agrees to assume the liability of another and then breaches that agreement.[445]

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[435] 90 Md. App. 320, 600 A.2d 1174 (1992).

[436] *Id*. at 321-22, 600 A.2d at 1176.

[437] *Id*.

[438] *Id*.

[439] *Id*. at 322, 600 A.2d at 1175.

[440] *Id*.

[441] *Id*.

[442] *Id*. at 323, 600 A.2d at 1176.

[443] *Id*. at 325-26, 600 A.2d at 1177 (emphasis added).

[444] *Id*. at 325, 600 A.2d at 1177.

[445] *See, e.g., Reliance Ins. Co. v. Gary C. Wyatt, Inc.*, 540 So.2d 688 (Alaska 1988); *Olympic Inc. v. Providence Washington Ins. Co.*, 648 P.2d 1008 (Alaska 1982); *Silva & Hill Constr. Co. v. Employers Mut. Liab. Ins. Co.*, 97 Cal.

6. Supplementary Payments Provision

In certain situations, an insured's indemnitee may be owed a defense by the insurer. The Supplementary Payments section of the CGL policy provides, in pertinent part, as follows:

> **SUPPLEMENTARY PAYMENTS – COVERAGES A AND B**
> * * *
> **2.** If we defend an insured against a "suit" and an indemnitee of the insured is also named as a party to the "suit", we will defend that indemnitee if all of the following conditions are met:
> **a.** The "suit" against the indemnitee seeks damages for which the insured has assumed the liability of the indemnitee in a contract or agreement that is an "insured contract";
> **b.** This insurance applies to such liability assumed by the insured;
> **c.** The obligation to defend, or the cost of the defense of, that indemnitee, has also been assumed by the insured in the same "insured contract";
> **d.** The allegations in the "suit" and the information we know about the "occurrence" are such that no conflict appears to exist between the interests of the insured and the interests of the indemnitee;
> **e.** The indemnitee and the insured ask us to conduct and control the defense of that indemnitee against such "suit" and agree that we can assign the same counsel to defend the insured and the indemnitee; and
> **f.** The indemnitee:
> **(1)** Agrees in writing to:
> **(a)** Cooperate with us in the investigation, settlement or defense of the "suit";
> **(b)** Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the "suit";
> **(c)** Notify any other insurer whose coverage is available to the indemnitee; and
> **(d)** Cooperate with us with respect to coordinating other applicable insurance available to the indemnitee; and

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Rptr. 498 (Cal. App. 1971).

(2) Provides us with written authorization to:

(a) Obtain records and other information related to the "suit"; and

(b) Conduct and control the defense of the indemnitee in such "suit".

So long as the above conditions are met, attorneys' fees incurred by us in the defense of that indemnitee, necessary litigation expenses incurred by us and necessary litigation expenses incurred by the indemnitee at our request will be paid as Supplementary Payments. Notwithstanding the provisions of Paragraph **2.b.(2)** of Section **I** - Coverage **A** - Bodily Injury And Property Damage Liability, such payments will not be deemed to be damages for "bodily injury" and "property damage" and will not reduce the limits of insurance.

Our obligation to defend an insured's indemnitee and to pay for attorneys' fees and necessary litigation expenses as Supplementary Payments ends when:

a. We have used up the applicable limit of insurance in the payment of judgments or settlements; or

b. The conditions set forth above, or the terms of the agreement described in Paragraph **f.** above, are no longer met.

The Supplementary Payments provision sets forth the conditions which must be satisfied in order for the indemnitee to be entitled to a defense, paraphrased as follows:

1. The insured and indemnitee must be named as defendants in the same suit.

2. The insured must have assumed the liabilities of the indemnitee in an "insured contract."

3. The suit must seek damages for those liabilities.

4. The policy must cover those liabilities.

5. The insured must have assumed the cost of the indemnitee's defense (not merely indemnity) in the "insured contract."

6. There cannot be a conflict of interest between the insured and the indemnitee that would preclude a shared defense. This is a very difficult condition to satisfy. There may be no conflict where the insured and the indemnitee are in agreement as to the facts and believe that no liability

exists for the indemnitee. The potentiality of a conflict is a problem.

7. The insured and the indemnitee ask the insurer for, and agree to have, a shared defense. The same legal counsel may handle the defense of both insured and indemnitee.

8. The indemnitee agrees to cooperate with the insurer and notify any other insurer whose coverage is available to the indemnitee. The obligations imposed upon the indemnitee under this requirement are similar to those imposed on the insured. The indemnitee's duty is continuing.

It is very difficult for an indemnitee to meet all of the requirements of this provision.

C. AIRCRAFT, AUTO AND WATERCRAFT EXCLUSIONS

The 1973 ISO policy eliminates coverage for aircraft, automobiles, and watercraft in exclusions (b) and (e):

> (b) to bodily injury or property damage arising out of the ownership, maintenance, operation, use, loading or unloading of
>
> (1) any automobile or aircraft owned or operated by or rented or loaned to any insured, or
>
> (2) any other automobile or aircraft operated by any person in the course of his employment by any insured;
>
> but this exclusion does not apply to the parking of an automobile on premises owned by, rented to or controlled by the named insured or the ways immediately adjoining, if such automobile is not owned by or rented or loaned to any insured;
>
> * * *
>
> (e) to bodily injury or property damage arising out of the ownership, maintenance, operation, use, loading or unloading of
>
> (1) any watercraft owned or operated by or rented or loaned

to any insured, or

(2) any other watercraft operated by any person in the course of his employment by any insured;

but this exclusion does not apply to watercraft while ashore on premises owned by, rented to or controlled by the named insured;

The corresponding 1986 ISO policy employs exclusion (g):

(g) "Bodily injury" or "property damage" arising out of the ownership, maintenance, use or entrustment to others of any aircraft, "auto" or watercraft owned or operated by or rented or loaned to any insured. Use includes operation and "loading or unloading."

This exclusion does not apply to:

(1) A watercraft while ashore on premises you own or rent;

(2) A watercraft you do not own that is:
(a) Less than 26 feet long; and
(b) Not being used to carry persons or property for a charge;

(3) Parking an "auto" on, or on the ways next to, premises you own or rent, provided the "auto" is not owned by or rented or loaned to you or the insured;

(4) Liability assumed under any "insured contract" for the ownership, maintenance or use of aircraft or watercraft; or

(5) "Bodily injury" or "property damage" arising out of the operation of any of the equipment listed in paragraph f.(2) or f.(3) of the definition of "mobile equipment."

The 2001 revision addresses the issue of negligent entrustment:

> This exclusion applies even if the claims against any insured allege negligence or other wrongdoing in the supervision, hiring, employment, training or monitoring of others by that insured, if the "occurrence" which caused the "bodily injury" or "property damage" involved the ownership, maintenance, use or entrustment to others of any aircraft, "auto" or watercraft that is owned or operated by or rented or loaned to any insured.

The purpose of these exclusions is to prevent duplication of coverage.[446] Automobile, aircraft or watercraft insurance policies are not intended to cover general liability hazards and general liability insurance is not intended to cover automobile, aircraft or watercraft hazards. There are specific policies available for those hazards.[447]

The 1986 ISO policy specifically excludes "entrustment" situations, and the 2001 revision has fortified the language on this point. Some courts have held that the 1973 ISO policy covered "negligent entrustment." In *Rubins Contractors, Inc. v. Lumbermens Mut. Ins.*,[448] the Court held that a general business liability policy did not cover negligent entrustment.[449]

D. MOBILE EQUIPMENT EXCLUSION

In the 1973 ISO policy the mobile equipment exclusion was contained in exclusions (c) and (d):

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[446] *See Gallegos v. Allstate Ins. Co.*, 372 Md. 748, 816 A.2d 102 (2003) (auto exclusion in homeowner's policy does not violate §19-202 of the Insurance Code, which requires homeowner's insurance carriers to provide at least $300,000 in coverage for injuries arising from family day care activity).

[447] *See generally* 7A J. Appleman, *Insurance Law and Practice* §§ 4500.03 and 4500.04 (Berdal ed. 1979 & 2003 Cum. Supp.); 9 *Couch on Insurance 3d* § 127:1 (3d ed. 2003); David B. Harrison, Annotation, *Construction and Effect of Provision Excluding Liability for Automobile-Related Injuries or Damage From Coverage of Homeowner's or Personal Liability Policy*, 6 A.L.R. 4th 555 (1981). *See also Classic Hosiery, Inc. v. Royal Ins. Co. of Am.*, 568 N.Y.S.2d 254 (App. Div. 1991) (applying the 1986 exclusion).

[448] 821 F.2d 671, 675-77 (D.C. Cir. 1987) (Md. law).

[449] For a discussion of a similar exclusion concerning watercraft, see Francis M. Dougherty, Annotation, *Construction and Effect of the Provision of Homeowner' s Premises or Personal Liability Insurance Policy Covering or Excluding Watercraft*, 26 A.L.R. 4th 967 (1983). *Cf. Consola Am. Ins. v. Mike Soper Marine Serv.*, 942 F.2d 1421, 1424-25 (9th Cir. 1991) (holding the term "watercraft" ambiguous); *Snyder v. Travelers Ins. Co.*, 251 F. Supp. 76, 78 (D. Md. 1966) (specially designed floating crane fell within "watercraft" exclusions); *Walker v. Fireman's Fund Ins. Co.*, 66 Md. App. 687, 505 A.2d 884 (1986) (not applicable "to the ownership, maintenance, operation, use, loading or unloading of any aircraft other than aircraft chartered with crew by or on behalf of the insured...."). For a discussion of aircraft exclusions, see John E. Theuman, Annotation, *What is "Aircraft" or the Like Within Meaning of Exclusion or Exception Clause of Insurance Policy*, 39 A.L.R. 4th 214 (1985).

This insurance does not apply:
* * *

(c) to bodily injury or property damage arising out of (1) the ownership, maintenance, operation, use, loading or unloading of any mobile equipment while being used in any prearranged or organized racing, speed or demolition contest or in any stunting activity or in practice or preparation for any such contest or activity or (2) the operation or use of any snowmobile or trailer designed for use therewith;

(d) to bodily injury or property damage arising out of and in the course of the transportation of mobile equipment by an automobile owned or operated by or rented or loaned to any insured . . . .

In the 1986 ISO policy the mobile equipment exclusion is contained in exclusion (h):

This insurance does not apply to:
* * *

(h) "Bodily injury" or "property damage" arising out of:

(1) The transportation of "mobile equipment" by an "auto" owned or operated by or rented or loaned to any insured; or

(2) The use of "mobile equipment" in, or while in practice or preparation for, a prearranged racing, speed, or demolition contest, or in any stunting activity.

This exclusion is written to require the insured to purchase separate coverage for "mobile equipment" risks in two situations. First, where the mobile equipment is transported by auto, the insured needs to purchase separate coverage. This risk is normally covered by the auto liability insurance. Second, when the mobile equipment is used "in practice or preparation for a pre-arranged racing speed or demolition contest or in any stunting activity," then the insured must purchase separate coverage. Such highly hazardous activities are beyond the scope of a general liability policy and should be separately insured.

The 2004 edition of the CGL has been revised to eliminate coverage for bodily injury or property damage arising out of the ownership, maintenance or use of land vehicles that are subject to motor vehicle laws. This change in coverage has been accomplished by modifying the definitions of "mobile equipment" and “auto” to include

within the definition of "auto" all mobile equipment that is subject to "compulsory or financial responsibility law or other motor vehicle insurance law."[450]

E. POLLUTION COVERAGE AND THE POLLUTION EXCLUSION

1. CGL Coverage of Environmental Pollution in General

Faced with the harsh liability provisions of CERCLA and potentially devastating cleanup costs, potentially responsible parties look to their insurers to bear the cost. A number of specific insurance products are available to cover pollution risks, including those for pollution legal liability, property transfer, cleanup cost, cap/stop loss, Brownfields restoration and development, secured creditor, professional and contractor environmental liability, transporter insurance, storage tank pollution liability, closure and post-closure.[451]

Moreover, at least three endorsements to the CGL are available to provide some protection for this risk.[452] Despite this available coverage, the CGL has been at the center of the environmental coverage controversy. The 1973 ISO pollution exclusion resulted in considerable uncertainty and litigation. The 1986 ISO form introduced an "absolute pollution exclusion," which, despite its name, still contained some pollution coverage.[453]

2. The "Sudden and Accidental" Pollution Exclusion

The pollution exclusion clause was introduced as an endorsement in 1970 and began to be included as part of the ISO form in 1973. The Maryland Insurance Commissioner, however, did not permit a pollution exclusion until 1983.[454] The 1973 ISO policy pollution

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[450] *See* 2004 CGL (Appendix E) at Section V. 2.

[451] Stephanie K. Jones, *Environmental Pollution Insurance: A Fluid and Ever-Changing Market*, Insurance Journal (July 23, 2001).

[452] CG 04 22, Pollution Liability Coverage Extension Endorsement, deletes the first paragraph of the pollution exclusion (f), but maintains the exclusion for cleanup costs. CG 00 39, Pollution Liability Coverage Form [Designated Sites], is a claims-made form. It provides pollution liability coverage and reimbursement of mandated off-site cleanup costs for designated locations. CG 00 40, Pollution Liability Limited Coverage Form [Designated Sites], is a claims-made form. It provides pollution liability coverage for designated sites but no reimbursement for off-site cleanup costs.

[453] The absolute pollution exclusion may also be limited by exceptions. *See, e.g., Home Exterminating Co. v. Zurich-Am. Ins. Group*, 921 F. Supp. 318 (D. Md. 1996) (endorsement provided coverage for negligent application of pesticides).

[454] *Bentz v. Mut. Fire, Marine & Inland Ins. Co.*, 83 Md. App. 524, 532, 575 A.2d 795, 799 (1990).

exclusion stated:

> This insurance does not apply:
> * * *
> (f) to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials, or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water; *but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental*. (emphasis added).

In other words, the 1973 CGL policy covered "occurrences" *unless* they arose out of pollution events. Pollution events were not covered *unless* they were sudden and accidental. Read as a whole, the policy covered "continued and repeated exposures" except for exposures to pollution; then it covered only "sudden and accidental events."[455]

Most of the litigation surrounding the 1973 version of the pollution exclusion centered around the exception to the exclusion, *viz.* "sudden and accidental" events. Hence, the exclusion became known as the "sudden and accidental pollution exclusion."[456] As the meaning of "accidental" is fairly well understood, most of the litigation concerned the meaning of "sudden." Insurers argued that it meant "abrupt"; insureds argued it meant "unexpected" or "unintended." In *Bentz v. Mut. Fire, supra,* the Court of Special Appeals of Maryland said that "sudden and accidental . . . does not apply to gradual pollution, carried out on an ongoing basis during the course of business."[457]

In *Am. Motorists Ins. Co. v. Artra Group, Inc.*,[458] the Court of Appeals of Maryland addressed the exclusion for the first time. The Court held that a longstanding business practice which results in pollution may not be considered "sudden and accidental."[459] In

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[455] *Id.* at 538, 575 A.2d at 801-02 (1990) (*quoting Am. Motorists Ins. Co. v. Gen. Host Corp.*, 667 F. Supp. 1423, 1429 (D. Kan. 1987)), *aff'd*, 946 F.2d 1482 (10th Cir. 1991).

[456] *See, e.g., Bernhardt v. Hartford Fire Ins. Co.*, 102 Md. App. 45, 648 A.2d 1047 (1994). The "sudden and accidental" pollution exclusion is also sometimes referred to as the "qualified" pollution exclusion, contrasted with the "absolute" pollution exclusion.

[457] 83 Md. App. at 538, 575 A.2d at 801-02. Both *Bentz* and *Home Exterminating, supra,* involved contamination by pesticide companies.

[458] 338 Md. 560, 659 A.2d 1295 (1995).

[459] The Court also held for the first time that a limited exception to the Maryland choice-of-law rule of *lex loci*

Artra, the Maryland Department of the Environment required Sherwin-Williams to investigate and remedy hazardous waste contamination in the soil and groundwater at its Hollins Ferry site.[460] Sherwin-Williams filed suit against Artra and other previous owners seeking reimbursement for costs of investigation and remediation.[461] The complaint alleged that "numerous spills of hazardous substances and hazardous wastes were released at the Site during and as a result of regular operations of the plant."[462] Artra requested that American Motorists defend and indemnify it.[463]

American Motorists had issued nine CGL policies covering April 1, 1976 through April 1, 1985. Each policy contained a pollution exclusion (the pre-1986 version). American Motorists had also issued an umbrella policy containing similar language, which was in effect from 1976 to 1978.[464] American Motorists denied coverage and filed a declaratory judgment action.[465] The trial court ruled for American Motorists and the Court of Special Appeals reversed.[466]

Relying on *Bentz*, *supra*, and a trend in out-of-state appellate decisions, the Court of Appeals held that pollution due to longstanding routine business operations could not be considered "sudden and accidental."[467] The Court rejected the argument long urged by

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contractus exists under the doctrine of *renvoi*. Artra argued that *lex loci contractus* required that Illinois law apply. Illinois law holds the 1973 qualified pollution exclusion to be ambiguous. *See Outboard Marine v. Liberty Mut. Ins.*, 607 N.E.2d 1204 (Ill. 1992). American Motorists argued that the Maryland courts should look to the entire body of Illinois law, including Illinois conflict of law principles, and determine whether Illinois would apply Maryland law. Illinois applies the "most significant relationship" test set forth in *Restatement (Second) of Conflicts of Law* §§ 188 and 193 (1971); hence, Illinois would apply Maryland substantive law. The Court of Appeals held that Maryland courts should apply Maryland substantive law to contracts entered into in foreign states' jurisdictions notwithstanding the doctrine of *lex loci contractus* when: (1) Maryland has the most significant relationship with respect to the contract issue presented; and (2) the state where the contract was entered into would not apply its own substantive law to the issue before the court.

[460] 338 Md. at 563-64, 659 A.2d at 1296-97.

[461] *Id*. at 564, 659 A.2d at 1297.

[462] *Id*.

[463] *Id*. at 564, 659 A.2d at 1297.

[464] *Id*. at 564-65, 659 A.2d at 1297.

[465] *Id*.

[466] *Id*. at 566-67, 659 A.2d at 1298.

[467] *Id*. at 590, 659 A.2d at 1310.

insureds that "sudden" means merely “unexpected” and does not contain a time component. The Court further rejected a “microanalysis” of each allegation on a release-by-release basis when there is a course of longstanding pollution.[468] The allegations of the complaint reflected that the alleged pollution at the site was due to a variety of ongoing activities that were part of routine business operations.[469] These allegations did not constitute instances of sudden and accidental pollution.[470] The Court held there was neither a duty to defend nor a duty to indemnify.[471]

In *Alcolac, Inc. v. St. Paul Fire & Marine Ins. Co.*,[472] the U.S. District Court for the District of Maryland addressed, *inter alia*, the intentional injury and sudden and accidental pollution exclusions. There, in the underlying tort case, a Missouri jury had awarded substantial compensatory and punitive damages against the insured for injuries caused by Alcolac's systematic discharge of pollutants into the environment. The Court held that the acts were neither unintended nor “sudden and accidental.” As to the intentional injury exclusion, the Court reasoned:

> The better-reasoned authority is to the effect that, when pollutants regularly have escaped over a period of years, especially when management was either deliberately indifferent to the situation or consciously disregarded it, coverage is excluded under the policy definition of “occurrence,” because damage is to be expected with a substantial degree of probability . . . . The jury's award of punitive damages [in the underlying tort case] shows a consciousness of wrongdoing on Alcolac's part that renders the consequences of that conduct “expected” within the common meaning of that term.[473]

The Court distinguished cases where there was long-term, unintentional pollution.[474]

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[468] *Id.* at 587-90, 659 A.2d at 1308-11.

[469] *Id*. at 586-87, 659 A.2d at 1308-09.

[470] *Id*.

[471] *Id*. at 594, 659 A.2d at 1311-12.

[472] 716 F. Supp. 1541 (D. Md. 1989).

[473] *Id*. at 1544-45.

[474] *See, e.g., Mraz v. Canadian Universal Ins. Co.*, 804 F.2d 1325 (4th Cir. 1986) (contamination discovered 12 years after insured stored chemicals with cooperation of governmental agencies); *Steyer v. Westvaco Corp.*, 450 F. Supp. 384 (D. Md. 1978) (insurer had duty to defend where complaint asserted claims based on theories of nuisance, trespass, strict liability and negligence in connection with alleged damage to Christmas tree crop from fumes from pulp mill over period of four years).

The Court held that the discharge of pollutants did not fall within the "sudden and accidental" exception to the pollution exclusion, reasoning that under the facts presented in the tort trial no fact finder could reasonably conclude that the insured's acts were sudden and accidental.[475]

3. The "Absolute" Pollution Exclusion

The 1986 ISO CGL pollution exclusion reads:

> f. (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:
>
> (a) At or from premises you own, rent or occupy;
>
> (b) At or from any site or location used by or for you or others for the handling, storage, disposal, processing or treatment of waste;
>
> (c) Which are at any time transported, handled, stored, treated, disposed of, or processed as waste by or for you or any person or organization for whom you may be legally responsible; or
>
> (d) At or from any site or location on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations:
>
> (i) if the pollutants are brought on or to the site or location in connection with such operations; or
>
> (ii) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify

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[475] *Alcolac*, 716 F. Supp. at 1543-44.

or neutralize the pollutants.

(2) Any loss, cost or expense arising out of any governmental direction or request that you test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.[476]

The absolute pollution exclusion is in two parts. The first part is contained in section f.(1). It concerns "bodily injury" or "property damage" arising out of specified polluting events. The second part is contained in section f.(2). It excludes "[a]ny loss, cost or expense arising out of any governmental direction or request."[477]

The 1986 exclusion differs from the prior exclusion in that there is no exception for "sudden and accidental" pollution. It excludes all bodily injury and property damage except for a few situations. Clean up costs are specifically excluded. Coverage for pollution from completed operations is not barred by the exclusion.

While almost all courts that have addressed the "absolute" pollution exclusion have found it unambiguous on the facts presented, [478] some courts have been reluctant to apply it

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[476] The definition of "pollutants" is moved to Section V, Definitions, in the 1998 version of the policy.

[477] For an excellent discussion of this exclusion, see Stevan A. Miller and Julianne L. Swilley, *The Absolute Pollution Exclusion in General Liability Insurance Policies, Reference Handbook on the Comprehensive General Liability Policy* 145 (Peter J. Neeson ed. 1995).

[478] In *Alcolac, Inc. v. Cal. Union Ins. Co.*, 716 F. Supp. 1546 (D. Md. 1989), arising out of the same underlying Missouri tort case as *Alcolac v. St. Paul, supra*, Judge Smalkin addressed the "absolute pollution" exclusion and held:

> There is no ambiguity in the clause, it is clear on its face, and the damages in the underlying litigation unquestionably flowed from events within its ambit. This pollution exclusion is just what it purports to be - absolute - and the Court perceives no reason why Cal Union should be denied the benefit of its bargain with Alcolac, as reflected in the insurance contract.

Id. at 1549. Other courts have reached the same conclusion. *See, e.g., Smith v. Hughes Aircraft Co.*, 783 F. Supp. 1222 (D. Ariz. 1991); *Colonial Tanning Corp. v. Home Indem. Co.*, 780 F. Supp. 906 (N.D. N.Y. 1991); *Vantage Dev. Corp. v. Am. Env'ts Tech. Corp.*, 598 A.2d 948 (N.J. Super. 1991). *See generally* Barry R. Ostrager and Thomas R. Newman, *Handbook on Insurance Coverage Disputes*, at § 8.01 *et. seq.* (4th ed. 1991); William B. Johnson, Annotation, *Construction and Application of Pollution Exclusion Clause in Liability Insurance Policies*, 39 A.L.R. 4th 1047 (1985);

to personal injury cases. Nationwide, the courts split essentially on whether they apply the language of the exclusion or the "purpose" of the exclusion.

In *Bernhardt v. Hartford Fire Ins.*,[479] the Court of Special Appeals applied the language of the absolute pollution exclusion to an indoor bodily injury situation. Norman Bernhardt was the owner of a house which had been converted into apartments.[480] On January 31, 1992, several tenants were overcome by carbon monoxide and were taken to area hospitals for treatment.[481] The tenants contended the source of the gas was a defectively maintained furnace.[482] The landlord contended the source was a blocked chimney.[483] The tenants made claims, and one filed suit.[484] The landlord brought a declaratory judgment action against his CGL insurer, Hartford Fire Insurance Co. ("Hartford").[485] The trial court granted summary judgment to the insurer and the landlord appealed.[486]

Carol A. Crocca, Annotation, *Liability Insurance Coverage for Violation of Anti-Pollution Laws*, 87 A.L.R. 4th 444 (1991); 7A J. Appleman, *Insurance Law and Practice* § 4499.05 (Berdal ed. 1979, 2003 Cum. Supp.). *But see Brantley Dev. Group, Inc. v. Harford Mut. Ins. Co*., 12 No. 7 Andrews Ins. Covg. Litig. Rep. 3 (Dec. 18, 2001), No. 13-C-99-42636, (Circ. Ct. for Howard County, May 22, 2001) (Leasure, J.). In *Brantley*, the Court held that the absolute pollution exclusion was inapplicable to claims of negligent construction against a builder who allegedly built the plaintiffs' houses on a solid waste dump. The insurer had denied coverage based upon the absolute pollution exclusion. The builder contended that the negligence claims against the builder were separate from the claims concerning the release of pollutants. The Court agreed, observing that the exclusion did not depend on the causes of action asserted, but rather on the nature of the damages alleged. The Court further noted that the complaint alleged negligence in the preparation and construction of the houses, including improper and inadequate preparation of the land and foundation pads, improper and inadequate construction of the houses, and structural damage and major structural defects in the houses. She concluded that all of these allegations were sufficient to remove the negligence claims from the ambit of the exclusion. Another case analyzing a pollution exclusion under Maryland law is *Meintzer & Sons, Inc. v. Nationwide Mut. Ins.*, Civ. A. No. HAR 91-353, 1992 WL 12994 (D. Md. Jan. 14, 1992), which concerns an automobile pollution exclusion.

[479] 102 Md. App. 45, 648 A.2d 1047 (1994).

[480] *Id*. at 47, 648 A.2d at 1047.

[481] *Id*.

[482] *Id*.

[483] *Id*. at 47, 648 A.2d at 1048.

[484] *Id*. at 48, 648 A.2d at 1048.

[485] *Id*.

[486] *Id*.

The policy contained an "absolute pollution exclusion," which was substantially similar to that in the 1986 ISO CGL. It excluded, in pertinent part:

> bodily injury ... arising out of the actual ... discharge, dispersal, release or escape of pollutants ... at ... premises owned ... by the named insured.

The policy defined "pollutant" to include "any ... gaseous or thermal irritant or contaminant, including smoke, ... fumes ... [and] chemicals."[487]

The landlord contended that, "notwithstanding the literal language of the exclusion, the parties intended that it apply only to persistent industrial pollution of the environment, and not to an accident of the kind generally covered by a comprehensive business liability policy; and . . . the exception to the exclusion applies because the damage was 'caused by. . . fumes from a hostile fire.'"[488]

The Court of Special Appeals rejected the landlord's second argument because there was no evidence that the fire in the furnace became "uncontrollable" or "[broke] out from where it was intended to be," as required by the exception to the exclusion.[489] The landlord's counsel proffered at the hearing on summary judgment that the injuries were caused when a blockage of free air passage occurred in the chimney flue, causing a build-up and dispersal of carbon monoxide through the building."[490]

The landlord's argument concerning the intent of the pollution exclusion required more analysis. The Court began by reviewing the history of the exclusion (referring to *Bentz v. Mut. Fire*[491]). The history revealed that the insurance industry had consistently revised its policy language to exclude pollution coverage.[492]

The Court then reviewed the rules of construction and concluded:

> The carbon monoxide gas in this case was a "gaseous ... irritant or

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[487] *Id*. at 48-49, 648 A.2d at 1048.

[488] *Id.* at 50, 648 A.2d at 1049.

[489] *Id.*

[490] *Id*.

[491] 83 Md. App. 524, 575 A.2d 795 (1990).

[492] *Bernhardt*, 102 Md. App. at 51-53, 648 A.2d at 1049-50.

> contaminant" and constituted "fumes" and "chemicals" within the clear language of the definition of "pollutant." Moreover, the bodily injury claimed by the tenants "arose out of the actual . . . discharge, dispersal . . . or escape" of the carbon monoxide, "at . . . premises owned . . . by the named insured.[493]

Finally, the landlord argued that the insurer should be estopped from denying coverage due to representations made by the insurance industry to the Insurance Commissioner when the endorsement was presented for approval.[494] The Court rejected that argument as there was no evidence of such representations before it.[495]

The argument for limiting the scope of coverage based on "regulatory estoppel," that is, based upon representations made to the Insurance Commissioner, has become a hot point for litigating these issues.[496]

A year after the decision in *Bernhardt*, the Court of Appeals of Maryland focused on the purpose of the exclusion and held that the pollution exclusion does not preclude coverage in the lead paint poisoning context. In *Allstate Ins. Co. v. Sullins*,[497] the Court held that the absolute pollution exclusion does not relieve an insurer from its duty to defend or indemnify its insured in an underlying lead paint poisoning action brought against the insured by a tenant.[498] The Court reasoned that a pollutant did not include a substance that

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[493] *Id*. at 55, 648 A.2d at 1051.

[494] *Id*. at 56-57, 648 A.2d at 1052.

[495] *Id*. Representatives of the insurance industry seeking approval of the "sudden and accidental" exclusion made various representations to state regulatory representatives. The Insurance Rating Board (IRB), a predecessor to the ISO, submitted a standard memorandum to many state insurance commissioners as an explanation of the purpose of the exclusion. It reads in pertinent part: "Coverage for pollution or contamination is not provided in most cases under present policies because the damages can be said to be expected or intended and thus are excluded by the definition of occurrence. The above exclusion clarifies this situation so as to avoid any question of intent. Coverage is continued for pollution or contamination caused by injuries where the pollution or contamination results from an accident." *See, e.g., New Castle County v. Hartford Accid. and Indem. Co.*, 933 F.2d 1162, 1198 (3d Cir. 1991).

[496] *See, e.g., Morton Int'l, Inc. v. General Accid. Ins. Co.*, 629 A.2d 831 (N.J. 1993). *See generally* Zampino and Harwood, *The Pollution Exclusion: Debunking the Policyholders' Regulatory Estoppel Myth*, For The Defense (July 1995).

[497] 340 Md. 503, 667 A.2d 617 (1995).

[498] *Id*. at 518, 667 A.2d at 624. The Court disagreed with a federal district court's holding in *St. Leger v. The American Fire & Cas. Ins. Co.*, 870 F. Supp. 641 (E.D. P.A. 1994), finding that lead paint was unambiguously a pollutant within the pollution exclusion under Maryland law.

was used intentionally and legally.[499] The Court further reasoned that the terms "irritant" and "contaminant," when viewed in isolation, are virtually boundless, for "there is virtually no substance or chemical in existence that would not irritate or damage some person or property."[500] The Court reasoned that the pollution exclusion encompassed only environmental pollution damage.[501] The Court explained that the terms "discharge," "dispersal," "release," "escape," "contaminant" and "pollutant" are "terms of art in environmental law and are used by Maryland courts to refer to environmental exposure."[502] How this reasoning affected the *Bernhardt* decision was unclear.

The Fourth Circuit followed the *Bernhardt* analysis in *Assicurazioni Generali, S.p.A. v. Neil,*[503] reversing the judgment of the District Court, which had concluded, based upon dicta in *Sullins*, that the Court of Appeals of Maryland would restrict the application of the "pollution exclusion" to environmental pollution and thus would overrule *Bernhardt.*[504] The Fourth Circuit rejected this analysis. The Fourth Circuit noted that the Court of Appeals in *Sullins* "principally relied on *Bernhardt* in recounting the history of the pollution exclusions."[505] Moreover, the Fourth Circuit noted that in *Sullins*, the Court of Appeals applied the terms "contaminants" and "pollutants" and found them ambiguous in determining whether lead paint chips constituted a contaminant or pollutant as defined in the policy.[506] In contrast, in *Bernhardt*, the Court of Special Appeals found that "carbon monoxide was clearly a 'gaseous….irritant or contaminant' and constituted 'fumes' and 'chemicals' within the clear language of the definition of 'pollutant.'"[507] Therefore, no ambiguity was found in *Bernhardt*.

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[499] *Sullins*, 340 Md. at 516, 667 A.2d at 623.

[500] *Id*. at 512, 667 A.2d at 621.

[501] *Id.* at 514-16, 667 A.2d at 622-24.

[502] *Id*. at 511, 667 A.2d at 620-21.

[503] 160 F.3d 997, 1004-06 (4th Cir. 1998). *See generally* Schultheis, Sullins v. Allstate*: Lead Paint and the Growing Ambiguity of the Pollution Exclusion Clause,* 27 U. Balt. L. Rev. 476 (1998).

[504] The trial court reasoned that *Sullins* "essentially held that the standard pollution exclusion applies to what, in common sense, it ought to apply, *viz.*, to pollution of the physical environment that is the contamination of the air and water that surround us all, not contamination of indoor living space." *Assicurazioni Generali*, 160 F.3d at 1004.

[505] *Id.* (citing *Sullins, supra*, 340 Md. at 514, 667 A.2d at 622).

[506] *Id.* at 1005.

[507] *Id.* at 1005 (citing *Bernhardt, supra*, 102 Md. App. at 54, 648 A.2d at 1051).

Nothing in these two analyses is in conflict. However, in *Sullins*, the Court of Appeals went on to state that the history of the pollution exclusion would support the conclusion of an "intention by the insurance industry 'to exclude only environmental pollution damage from coverage.'"[508] The Fourth Circuit reasoned that the *Sullins* court applied this conclusion only to the circumstances of the case before it. Hence, the Fourth Circuit concluded that *Sullins* did not undermine the *Bernhardt* holding "that when a court examines language in a pollution exclusion that unambiguously applies to a cause of alleged injuries, the exclusion bars coverage of those injuries, regardless of what the drafting history may suggest about the original intent of such exclusions."[509] Thus, the Fourth Circuit concluded that "the language of the pollution exclusion in *Bernhardt* and in the case at hand unambiguously applies to injuries from carbon monoxide."[510] Therefore, under Maryland law, the pollution exclusion precludes coverage for indoor carbon monoxide injuries. Numerous out-of-state courts have addressed this issue as well.[511]

The *Bernhardt* and *Assicurazioni Generali* decisions have been superceded by the 1996 ISO revisions containing a mandatory endorsement; CG 00 54 – Amendment of Pollution Exclusion – Exception for Building Heating Equipment. It provides that where smoke, fumes, vapor, or soot from heating equipment causes bodily injury within a

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[508] *Id.* (citing *Sullins, supra*, 340 Md. at 514, 667 A.2d at 622).

[509] *Id.*

[510] *Id.*

[511] *See, e.g., Am. States Ins. Co. v. Nethery*, 79 F.3d 473 (5th Cir. 1996) (pollution exclusion precluded claim that fumes from paint and glue inflamed claimants' hypersensitivity to chemicals); *Regional Bank of Colo., N.A. v. St. Paul Fire & Marine Ins. Co.*, 35 F.3d 494 (10th Cir. 1994) (carbon monoxide from residential heater was not excluded contaminant or irritant); *Brown v. Am. Motorists Ins*., 930 F. Supp. 207 (E.D. Pa. 1996) (fumes from chemical waterproofing sealant applied to exterior of plaintiff's home fell within pollution exclusion); *Western Alliance Ins. Co. v. Gill*, 686 N.E.2d 997 (Mass. 1997) (restaurant patron who was injured by carbon monoxide fumes did not suffer a pollution related accident); *Am. States Ins. Co. v. Koloms*, 687 N.E.2d 72 (Ill. 1997) (absolute pollution exclusion in commercial landlord's CGL policy applied only to traditional environmental pollution, and an accidental release of carbon monoxide due to a broken furnace did not constitute environmental pollution within exclusion); *Cook v. Evanson*, 920 P.2d 1223 (Wash. App. 1996) (pollution exclusion in building contractor's CGL policy precluded coverage for respiratory injuries sustained when fumes from concrete sealant entered building); *State Farm Fire & Cas. Ins. Co. v. Deni*, 678 So. 2d 397 (Fla. App. 1996) (pollution exclusion applied to indoor ammonia spill and insecticide accidentally sprayed on bystanders); *Motorists Mut. Ins. Co. v. RSJ, Inc.*, 926 S.W.2d 679 (Ky. App. 1996) (exposure to carbon monoxide fumes that leaked from a vent pipe in dry cleaners fell within absolute pollution exclusion); *Gamble Farm Inn, Inc. v. Selective Ins. Co.*, 656 A. 2d 142 (Pa. Super. 1995) ("atmosphere" within the meaning of the pollution exclusion does not include the air indoors); *Kenyon v. Security Ins. Co. of Hartford*, 626 N.Y.S.2d 347 (Sup. Ct. 1993) (pollution exclusion did not apply to claim of condominium resident who suffered carbon monoxide poisoning from faulty design or installation of furnace); *see generally* William B. Johnson, Annotation, *Construction and Application of Pollution Exclusion Clause in Liability Insurance Policy*, 39 A.L.R. 4th 1047 (1985).

building, it is covered. The 1998 changes withdraw this endorsement, but continue this coverage.[512]

In *Clendenin Bros. Inc. v. U.S. Fire Ins. Co.*[513] the Court of Appeals of Maryland concluded that a "total" pollution exclusion did not eliminate an insurer's duty to defend against a claim for personal injuries caused by workplace exposure to manganese fumes from the insured's welding products. The Court adopted the *Sullins* analysis, construing 'pollution' and 'contamination' ... as *not* encompassing lead paint, *a product used legally and intentionally.*"[514] The Court further adopted the *Sullins* analysis in holding that "the policy exclusion does not apply beyond traditional environmental pollution situations."[515] The Court noted that "[w]elding fumes emitted during the normal course of business appear to be the type of harm intended to be included under coverage for routine commercial hazards."[516] It concluded that the exclusion was ambiguous in the context of manganese welding fumes, observing that a "reasonably prudent person could construe the pollution exclusion clause . . . as both including and not including manganese welding fumes."[517] Hence, the Maryland appellate courts are construing the absolute and total pollution exclusions narrowly to bar solely "traditional environmental pollution." Defining "traditional environmental pollution," however, is likely to be problematical.

4. The 1998 Revisions To The Absolute Pollution Exclusion

The 1998 revisions provide:

This insurance does not apply to:
* * *
f. Pollution
(1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants":

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[512] *See* discussion, § 4, *infra.*

[513] 390 Md. 449, 889 A.2d 387 (2006).

[514] *Id*. at 463, 889 A.2d at 395-96.

[515] *Id*. at 466, 889 A.2d at 398.

[516] *Id*. at 467, 889 A.2d at 398.

[517] *Id*. at 461, 889 A.2d at 394.

(a) At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, any insured. However, this subparagraph does not apply to:

(i) "Bodily injury" if sustained within a building and caused by smoke, fumes, vapor or soot from equipment used to heat that building;

(ii) "Bodily injury" or "property damage" for which you may be held liable, if you are a contractor and the owner or lessee of such premises, site or location has been added to your policy as an additional insured with respect to your ongoing operations performed for that additional insured at that premises, site or location and such premises, site or location is not and never was owned or occupied by, or rented or loaned to, any insured, other than that additional insured; or

(iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire";

(b) At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage, disposal, processing or treatment of waste;

(c) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for any insured or any person or organization for whom you may be legally responsible; or

(d) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the "pollutants" are brought on or to the premises, site or location in connection with such operations by such insured, contractor or subcontractor. However, this subparagraph does not apply to:

(i) "Bodily injury" or "property damage" arising out of the escape of fuels, lubricants or other operating fluids which are needed to perform the normal electrical, hydraulic or mechanical functions necessary for the operation of "mobile equipment" or its parts, if such fuels, lubricants or other operating fluids escape from a vehicle part designed to hold, store or receive them. This exception does not apply if the "bodily injury" or "property damage" arises out of the intentional discharge, dispersal or release of the fuels, lubricants or other operating fluids, or if such fuels, lubricants or other operating fluids are brought on or to the premises, site or location with the intent that they be discharged, dispersed or released as part of the operations being performed by such insured, contractor or

subcontractor;

(ii) "Bodily injury" or "property damage" sustained within a building and caused by the release of gases, fumes or vapors from materials brought into that building in connection with operations being performed by you or on your behalf by a contractor or subcontractor; or

(iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire".

(e) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants".

(2) Any loss, cost or expense arising out of any:

(a) Request, demand, order or statutory or regulatory requirement that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants"; or

(b) Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of, "pollutants".

However, this paragraph does not apply to liability for damages because of "property damage" that the insured would have in the absence of such request, demand, order or statutory or regulatory requirement, or such claim or "suit" by or on behalf of a governmental authority.

The July 1998 ISO revisions withdrew CG 00 54– Amendment of Pollution Exclusion – Exception for Building Heating Equipment and added a three-part exceptions provision to the absolute pollution exclusion. Those provisions except from the exclusion: (1) Bodily injury or property damage caused by smoke, fumes, vapor, or soot from heating equipment used to heat a building; (2) Bodily injury or property damage for which the named insured, if a contractor, may be held liable and the owner or lessee of the premises is an additional insured for ongoing operations of the named insured performed for that additional insured; and (3) Bodily injury or property damage arising out of heat, smoke or fumes from a hostile fire. The first exception is a continuation of CG 00 54.

The second exception is designed to eliminate an anomaly for contractors. Under the prior coverage language, coverage was eliminated for injury arising from the release of pollutants at a site owned by *any* insured. Therefore, where the contractor's insurer names

the owner as an additional insured, any release of pollutants occurs on premises owned by an insured. The contractor's coverage is excluded inadvertently where it is working on a site where someone suffers bodily injury due to an escape of pollutants, through no fault of the contractor, simply because the owner is an additional insured. The revision is designed to correct this problem.

The third exception is designed to broaden the second part of the exclusion, i.e., clean up costs. In the past, the insured had no coverage for clean up costs, but may have had coverage for property damage due to that pollution event. This change makes clear that if the insured is liable for a pollution event, and has coverage due to an exception to the exclusion, coverage cannot be denied based upon the claim that the property damage is a clean up cost.

Some insurance companies use what is called the "Total Pollution Exclusion." Although the terms "absolute" and "total" are often used as synonyms, they represent different exclusions. The Total Pollution Exclusion provides:

> This endorsement modifies insurance provided under the following:
>
> > COMMERCIAL GENERAL LIABILITY COVERAGE PART
> > Exclusion **f.** under **Paragraph 2., Exclusions** of **Section I – Coverage A – Bodily Injury And Property Damage Liability** is replaced by the following:
> > This insurance does not apply to:
> > **f. Pollution**
> > (1) "Bodily injury" or "property damage" which would not have occurred in whole or part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants" at any time.
> > (2) Any loss, cost or expense arising out of any:
> > (a) Request, demand, order or statutory or regulatory requirement that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of "pollutants"; or
> > (b) Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing,

or in any way responding to, or assessing
the effects of, "pollutants".

Releases occurring away from the insured's premises are not excluded by the "absolute" pollution exclusion but are excluded by the "total" pollution exclusion.

5. What is a Pollutant?

a. Medical Waste

The determination of what constitutes a "pollutant" continues to evolve. The Fifth Circuit held that the absolute pollution exclusion barred coverage for an incident arising out of the disposal of biomedical nuclear waste.[518] The Sixth Circuit held that when a primer/sealer was used in its intended manner, the fumes from the primer that emanated and caused respiratory injury to a teacher were not pollutants.[519]

b. Lead-Based Paint Poisoning

The application of the pollution exclusions to lead-based paint poisoning cases has received a mixed reception from the courts.[520] Insureds argue that lead is not included in the policy's lengthy list of definitions, and one cannot readily infer that paint containing lead is a pollutant. On the other hand, some courts have held that lead paint is a chemical and a contaminant that can irritate or poison and falls within the general tenor of the specifically listed pollutants.

In *Allstate Insurance Co. v. Sullins*,[521] the Court held that the absolute pollution exclusion does not relieve an insurer of its duty to defend or indemnify its insured in an underlying lead paint poisoning action brought against the insured by a tenant. The Court reasoned that the terms "pollutant" and "contaminant" used in the exclusion suggested more than one meaning to a reasonably prudent lay person.[522] Hence, they were ambiguous and

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[518] *Constitution State Ins. Co. v. Iso-Tex, Inc.*, 61 F.3d 405 (5th Cir. 1995).

[519] *Meridian Mut. Ins. Co. v. Kellman*, 197 F.3d 1178 (6th Cir. 1999).

[520] *See, e.g.*, *Oates v. State*, 597 N.Y.S.2d 550, 552-54 (N.Y. Ct. Cl. 1993) (absolute pollution exclusion barred coverage); *Atlantic Mut. Ins. Co. v. McFadden*, 595 N.E.2d 762 (Mass. 1992) (lead in paint was not a pollutant and therefore 1973 ISO pollution exclusion did not bar coverage).

[521] 340 Md. 503, 667 A.2d 617 (1995).

[522] *Id*. at 509, 667 A.2d at 620.

should be construed against the insurer so as not to preclude coverage.[523] The Court noted a conflict in judicial opinions regarding whether lead paint is a "pollutant" within the meaning of the pollution exclusion.[524] It disagreed with a federal district court's holding, in *St. Leger v. The Am. Fire & Cas. Ins. Co.*,[525] that lead paint was unambiguously a pollutant within the pollution exclusion under Maryland law. The Court concluded that the pollution exclusion excluded only environmental pollution damage from coverage.[526] Whether this reasoning will apply outside the lead or indoor pollution context is unclear. The impact of this decision on indoor environmentally caused bodily injury cases is open to debate.[527]

A lead-based paint poisoning exclusion was enforced in *Nationwide Mut. Fire Ins. Co. v. Mekiliesky*.[528] There, the allegedly lead-poisoned child was born three weeks before the effective date of a lead poisoning exclusion, the Complaint did not allege exposure before the effective date of the exclusion, and there was no evidence of exposure *in utero.*[529] Finding no evidence that the exposure underlying the lead paint case occurred prior to the effective date of the exclusion, the Court concluded that "no potentiality of coverage over the subject claim existed and therefore Nationwide did not have a duty to defend or indemnify."[530]

F. WAR EXCLUSION

The 1973 ISO CGL policy war exclusion provides:

This insurance does not apply:

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[523] *Id*. at 509-10, 667 A.2d at 620.

[524] *Id*. at 517-18, 667 A.2d at 624.

[525] 870 F. Supp. 641 (E.D. Pa. 1994).

[526] *Id.*

[527] *See* discussion of *Assicurazioni Generali*, s*upra* at § III.E.3.

[528] 161 F.3d 3 (Table), No. 97-2338, 1998 WL 536356 (4th Cir. Aug. 13, 1998).

[529] 1998 WL 536356 at *2.

[530] *Id*. at *2. The Court found that the mailing of a lead exclusion constituted sufficient notice to the insured to relieve the insurer of its duty to defend. In July of 1991, Nationwide mailed to its existing policyholders an endorsement adding a new lead exclusion provision to become effective August 27, 1991. The insured argued that he did not receive any mail with regard to the policy change. Rejecting this argument, the Court found that the insured did not overcome the presumption of delivery and receipt of mail which arises when there is sufficient evidence that the item in question was properly mailed. *Id*. at *1-2.

* * *

(g) to bodily injury or property damage due to war, whether or not declared, civil war, insurrection, rebellion or revolution or to any act or condition incident to any of the foregoing, with respect to

(1) liability assumed by the insured under an incidental contract, or

(2) expenses for first aid under the Supplementary Payments provision.

The 1986 ISO CGL policy war exclusion excludes coverage as follows:

(i) "Bodily injury" or "property damage" due to war, whether or not declared, or any act or condition incident to war. War includes civil war, insurrection, rebellion or revolution. This exclusion applies only to liability assumed under a contract or agreement.

The 2004 ISO CGL policy war exclusion provides as follows:

This insurance does not apply to:
* * *

i. War

"Bodily injury" or "property damage", however caused, arising, directly or indirectly, out of:
(1) War, including undeclared or civil war;
(2) Warlike action by a military force, including action in hindering or defending against an actual or expected attack, by any government, sovereign or other authority using military personnel or other agents; or
(3) Insurrection, rebellion, revolution, usurped power, or action taken by governmental authority in hindering or defending against any of these.

The 1973 ISO policy war exclusion applied only to liability assumed under incidental contracts or for expenses for first aid under the supplementary payments provisions. The 1986 ISO policy exclusion applies to liability assumed under any contract. The "policy territory" in the 1973 policy and the "coverage territory" in the 1986 policy restrict coverage to the United States and Canada.[531] The 2004 ISO policy war exclusion is

[531] *See, e.g., Int'l Multifoods Corp. v. Commercial Union Ins. Co.*, 309 F.3d 76 (2d Cir. 2002) (construing war

much broader. It excludes any liability arising out of war. The definition of "war" includes undeclared war, civil war, warlike action by a military force, insurrection, rebellion, revolution, usurped power, or action taken by government authority in hindering or defending against any of these.

G. HOST-LIQUOR LIABILITY EXCLUSION

The 1973 ISO CGL policy host-liquor liability exclusion provides:

> This insurance does not apply:
> * * *
> (h) to bodily injury or property damage for which the insured or his indemnitee may be held liable
>
> (1) as a person or organization engaged in the business of manufacturing, distributing, selling or serving alcoholic beverages, or
>
> (2) if not so engaged, as an owner or lessor of premises used for such purposes, if such liability is imposed
>
> (i) by, or because of the violation of, any statute, ordinance or regulation pertaining to the sale, gift, distribution or use of any alcoholic beverage or
>
> (ii) by reason of selling, serving or giving of any alcoholic beverage to a minor or to a person under the influence of alcohol or which causes or contributes to the intoxication of any person;
>
> but part (ii) of this exclusion does not apply with respect to liability of the insured or his indemnitee as an owner or lessor described in (2) above.

The 1986 ISO CGL policy host-liquor liability exclusion provides:

> This insurance does not apply to:

---

exclusion clause in all-risks insurance policy).

* * *

c. Liquor Liability

"Bodily injury" or "property damage" for which any insured may be held liable by reason of:

(1) Causing or contributing to the intoxication of any person;

(2) The furnishing of alcoholic beverages to a person under the legal drinking age or under the influence of alcohol; or

(3) Any statute, ordinance or regulation relating to the sale, gift, distribution or use of alcoholic beverages.

This exclusion applies only if you are in the business of manufacturing, distributing, selling, serving or furnishing alcoholic beverages.

Dram shop insurance is available in states which have enacted dram shop acts.[532] The exclusion is clear and unambiguous.[533] Maryland has not adopted, by common law or by statute, dram shop liability.[534] Further, Maryland courts have rejected social host liability to third persons for injuries caused by intoxicated guests or employees.[535]

H. WORKERS' COMPENSATION AND EMPLOYER'S LIABILITY EXCLUSIONS

The CGL contains two exclusions aimed at work-related claims. The Workers' Compensation exclusion provides that the insurance does not apply to any obligation of the insured under a workers' compensation, disability benefits or unemployment compensation law or any similar law. The Employer's Liability exclusion is designed to address other types of employment-related claims.

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[532] *See* 7A J. Appleman, *Insurance Law and Practice* § 4507 (Berdal ed. 1979 & 2003 Cum. Supp.).

[533] *See, e.g., Abe's Colony Club, Inc. v. C & W Underwriters, Inc.*, 852 S.W.2d 86 (Tex. App. 1993) (holding that the exclusion cannot be circumvented by allegations of negligent supervision, training or hiring).

[534] *See, e.g., Felder v. Butler*, 292 Md. 174, 438 A.2d 494 (1981); *see also Kuykendall v. Top Notch Laminates, Inc.*, 70 Md. App. 244, 520 A.2d 1115 (1987).

[535] *See, e.g., Hebb v. Walker*, 73 Md. App. 655, 536 A.2d 113 (1988).

In *Greathead v. Asplundh Tree Expert Co.*,[536] the Court described the purpose of the two exclusions:

> [T]he purpose of exclusions such as [the workers' compensation exclusion] is to exclude coverage of those employees protected by the workers' compensation law, whereas the language of [the employer's liability exclusion] acts to exclude liability for injury to employees *generally*. Although the two may overlap to a certain degree, they are not to be read together to exclude only those employees protected by workers' compensation.[537]

Thus, the employer's liability exclusion is broader and may apply to preclude coverage where workers' compensation insurance does not apply, i.e., where the employer failed to purchase coverage or where an employee is permitted to proceed against his employer in tort.

1. Workers' Compensation Exclusion

Coverage for workers' compensation, disability benefits and unemployment compensation is excluded by both the 1973 ISO policy, at exclusion (i), and the 1986 ISO policy, at exclusion "d."[538] Specifically designed policies are available to cover each risk.[539]

The 1973 ISO CGL policy workers' compensation exclusion provides:

> This insurance does not apply:
> * * *

[536] 473 So. 2d 1380 (Fla. App. 1985).

[537] *Id*. at 1383 (emphasis in original).

[538] *Nationwide v. Rhodes*, 127 Md. App. 231, 732 A.2d 388 (1999).

[539] *See, e.g., Bevans v. Liberty Mut. Ins. Co.*, 356 F.2d 577 (4th Cir. 1966) (construing "fellow employee" limitation in auto policy); *Wilson v. Nationwide Mut. Ins. Co.*, 395 Md. 524, 910 A.2d 1122 (2006) (holding that "fellow employee" exclusion in automobile liability policy limiting coverage to compulsory minimum amount was valid); *Travelers Indem. v. INA*, 69 Md. App. 664, 519 A.2d 760 (1987) (regarding the scope of a similar exclusion in the automobile insurance context); *Md. Cas. Co. v. INA*, 248 Md. 704, 238 A.2d 88 (1968) (same); *Lowitt v. Pearsall Chemical Corp.*, 242 Md. 245, 219 A.2d 67 (1966) (analyzing a predecessor workers' compensation exclusion). *See generally* 7A J. Appleman, *Insurance Law and Practice* § 450.05 (Berdal ed. 1979 & 2003 Cum. Supp.); 14 *Couch on Insurance 3d* § 201:73 (3d ed. 2003); Robert A. Shapiro, Annotation, *Construction and Application of Provision of Liability Policy, Other Than Automobile Liability, Excluding from Coverage Injury or Death of Employee of Insured*, 34 A.L.R. 3d 1397 (1970).

(i) to any obligation for which the insured or any carrier as his insurer may be held liable under any workmen's compensation, unemployment compensation or disability benefits law, or under any similar law.

The 1986 ISO CGL policy workers' compensation exclusion provides:

This insurance does not apply to:

* * *

d. Any obligation of the insured under a workers compensation, disability benefits or unemployment compensation law or any similar law.

2. Employer's Liability Exclusion

The 1973 ISO CGL policy employer's liability exclusion provides:

This insurance does not apply:

* * *

(j) to bodily injury to any employee of the insured arising out of and in the course of his employment by the insured or to any obligation of the insured to indemnify another because of damages arising out of such injury; but this exclusion does not apply to liability assumed by the insured under an incidental contract;

The 1986 ISO CGL policy employer's liability exclusion provides:

This insurance does not apply to:

* * *

(e) "Bodily injury" to:

(1) An "employee" of the insured arising out of and in the course of:

(a) Employment by the insured; or

(b) Performing duties related to the conduct of the insured's business; or

(2) The spouse, child, parent, brother or sister of that "employee" as a consequence of paragraph (1) above.

This exclusion applies:

(1) Whether the insured may be liable as an employer or in any other capacity; and

(2) To any obligation to share damages with or repay someone else who must pay damages because of the injury.

This exclusion does not apply to liability assumed by the insured under an "insured contract".

Exclusion (j) under the 1973 policy and exclusion "e" under the 1986 policy both exclude any claim arising out of any injury to an employee of the insured, where it arises out of, and in the course of, his employment by that insured. The 1986 exclusion has been broadened to further exclude any claim brought by the spouse, child, parent, brother or sister of the employee. The 1986 version also attempts to bar coverage for any claim brought by an employee under the "dual capacity" doctrine.[540]

An instructive out-of-state case on this exclusion is *Erdo v. Torcon Const. Co., Inc.*[541] In *Erdo*, a subcontractor's employee brought a personal injury action against the general contractor as a result of injuries sustained on the job site. The general contractor brought an action against the subcontractor's public liability insurer under whose policy it was an additional insured.[542] The Court held that the exclusion for bodily injury to any employee of the insured arising out of and in the course of employment by the insured did not apply to preclude coverage of the general contractor.[543] The exclusion was intended only to apply when an insured was sued by its own employees.[544]

The Fourth Circuit considered the effect of the employer's liability exclusion in *Cowan Syst., Inc. v. Harleysville Mut. Ins. Co.*[545] In *Cowan*, the employer of an injured

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[540] *See generally Hurt v. Pa. Threshermen & Farmers' Mut. Cas. Ins. Co.*, 175 Md. 403, 2 A.2d 402 (1938) (discussing the distinction between workers' compensation insurance and employer's liability insurance).

[541] 645 A.2d 806 (N.J. Super. 1994).

[542] *Id*. at 807-08.

[543] *Id*. at 809.

[544] *Id*.

[545] 457 F.3d 368 (4th Cir. 2006) (Md. law).

truck driver sought coverage under its CGL policy in connection with an indemnity claim against the employer by a third party who was sued by the truck driver. The truck driver claimed he was injured when he fell on the third party's property while delivering a trailer for his employer. The delivery was made pursuant to a transportation agreement between the employer and the third party which contained a provision in which the employer agreed to indemnify the third party in connection with personal injury claims arising out of the performance of the agreement.[546]

The policy barred coverage in connection with bodily injury to employees arising out of employment, regardless of any obligation by the insured "to share damages with or repay someone else who must pay damages because of the injury."[547]

The insurer contended that coverage was barred by the provision because the driver was employed by the insured at the time of the accident. The Court disagreed, noting that the exclusion contained an exception for "insured contracts," defined as

> [t]hat part of any other contract or agreement pertaining to your business . . . under which you assume the tort liability of another party to pay for "bodily injury" or "property damage" to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.[548]

The Court concluded, "Given this exception, if any employer enters an agreement to insure another party for its tort liability, then the employer's liability exclusion . . . is rendered inapplicable."[549]

I. CARE, CUSTODY AND CONTROL, PROPERTY OWNED AND ALIENATED PREMISES EXCLUSIONS

1. 1973 Exclusion K

The 1973 ISO policy exclusion (k)(1) was known as the "owned or occupied property" exclusion and (k)(3) was known as the "care, custody and control" exclusion:

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[546] *Id*. at 372-73.

[547] *Id*. at 374.

[548] *Id*.

[549] *Id.*

(k) to property damage to

(1) property owned or occupied by or rented to the insured.

(2) property used by the insured, or

(3) property in the care, custody or control of the insured or as to which the insured is for any purpose exercising physical control.

but parts (2) and (3) of this exclusion do not apply with respect to liability under a written sidetrack agreement and part (3) of this exclusion does not apply with respect to property damage (other than to elevators) arising out of the use of an elevator at premises owned by, rented to or controlled by the named insured. . . .

2. <u>1986 Exclusion J</u>

The 1986 ISO exclusion "j" combines the “owned property” exclusion, the “care, custody and control” exclusion, the “alienated premises” exclusion (formerly exclusion (l)), and part of the “Broad Form Property Damage” Endorsement:

This insurance does not apply to:

* * *

j. "Property damage" to:

(1) Property you own, rent or occupy;

(2) Premises you sell, give away or abandon, if the "property damage" arises out of any part of those premises;

(3) Property loaned to you;

(4) Personal property in your care, custody or control;

(5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations; or

(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

Paragraph (2) of this exclusion does not apply if the premises are "your work" and were never occupied, rented or held for rental by you.

Paragraphs (3), (4), (5) and (6) of this exclusion do not apply to liability assumed under a sidetrack agreement.

> Paragraph (6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".

Items (5) and (6) are derived from the Broad Form Property Damage Coverage.

Liability insurance is intended only to cover liability to third persons.[550] The owned property and care, custody and control exclusions are designed to avoid coverage on property that should be covered under property insurance.[551] Absent these exclusions, the liability policy might be converted into a first-party policy.[552] These exclusions eliminate coverage in situations in which the insured is closely connected with the damaged property by the exercise of some sort of control over it.[553] They reduce the "moral hazard" by removing any advantage to the insured of falsifying or exaggerating a loss and they prevent the insurer from becoming the guarantor of the insured's workmanship.[554]

a. Owned Property Exclusion J(1)

Exclusion j(1), the “owned property” exclusion, is similar to its predecessor, k(1). This is not so much an exclusion as a clarification that coverage is limited to third-party property damage. Insurers do not wish to fund the improvement of the insured’s property as a side benefit of third-party liability. The exclusion was not often litigated because the property at issue was usually insured by a first-party policy. This all changed with the advent of CERCLA, RCRA and other federal and state environmental cleanup statutes.[555] Generally, the exclusion has been upheld. Where there is damage to owned and non-owned property, issues arise concerning apportionment.[556]

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[550] *See, e.g., Bausch & Lomb v. Utica Mut. Ins. Co.*, 330 Md. 758, 625 A.2d 1021 (1993).

[551] *See, e.g., Harbor Court Assocs. v. Kiewit Constr. Co.*, 6 F. Supp. 2d 449, 460 (D. Md. 1998); *Broadwell Realty v. Fidelity & Cas. Co. of N. Y.*, 528 A. 2d 76, 82 (N.J. Super. App .Div. 1987), *overruled, on an unrelated issue, by Morton Int’l, Inc. v. Gen’l Accid. Ins. Co.*, 629 A. 2d 831 (N. J. 1993).

[552] *Bausch & Lomb*, 330 Md. at 783, 625 A.2d at 1033.

[553] *See, e.g., Reynolds v. Select Properties, Ltd.*, 616 So.2d 742 (La. App. 1993); *Arnold v. Adventure Line Mfg. Co.*, 495 P.2d 1007 (Kan. 1972).

[554] *See, e.g., Royal Indem. Co. v. Smith*, 173 S.E.2d 738 (Ga. App. 1970).

[555] *See, e.g., Metex Corp. v. Federal Ins. Co*., 845 F. Supp. 428, 441 (W. D. Mich. 1996); *Robert E. Lee & Assocs. v. Peters*, 557 N.W.2d 457, 464 (Wis. App. 1996).

[556] *See* Kirby Griffis, Note, *Apportionment of Environmental Cleanup Costs Under the Owned-Property Exclusion*

In *Aetna Insurance Co. v. Aaron*,[557] Maryland's intermediate appellate court rejected the application of an owned-property exclusion in a general liability insurance policy, holding that costs expended to prevent damage or injury to third parties are not excluded. There, the owner of an apartment unit was required to repair water leaks in her apartment and water damage to condominium units owned by other people and in the common areas of the condominium.[558] The Court reasoned that the fact that the repairs had to be done to the insured's own property did not exclude coverage where there was third-party property damage.[559]

Thus, the *Aaron* decision, and others like it, prompted the following change to j(1) in the 2001 edition of the policy:

> This insurance does not apply to:
> * * *
> (1) Property you own, rent, or occupy, *including any costs or expenses incurred by you, or any other person, organization or entity, for repair, replacement, enhancement, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another's property. . . .* (emphasis added).

Where repairs to the insured's property are necessary to avoid third-party property damage, such repairs are not covered property damage.

b. Alienated Premises Exclusion J(2)

The "alienated premises" exclusion is designed to eliminate coverage where the

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in CGL Insurance Policies, 80 Va. L. Rev. 1351 (September 1994).

[557] 112 Md. App. 472, 685 A.2d 858 (1996).

[558] *Id*. at 477, 685 A.2d at 860-61.

[559] *Id*. at 495, 685 A.2d at 869. *See also Harbor East-Office, LLC v. Travelers Cas. & Sur. Co.*, 201 F.3d 436 (Table), 1999 WL 672154 (4th Cir. Aug. 30, 1999) (where building foundation piles which were improper for type of soil at site were constructed on site, coverage for repairs to foundation was excluded because foundation became "owned property" when it was constructed on insured's land); *Bausch & Lomb, Inc. v. Utica Mut. Ins. Co*., 355 Md. 566, 735 A.2d 1081 (1999) (deletion of "owned-property" exclusion results in first-party coverage).

insured fails to repair property or disclose the existence of a defect in the premises prior to a sale.[560] Formerly exclusion (l), it is now contained in the 1986 policy as exclusion "j(2)." J(2), unlike the other sections of exclusion j, refers to “premises” rather than “property.”

c. Loaned Property Exclusion J(3)

"J(3)" excludes property loaned to the insured. Its application seems straightforward and there are not many reported decisions.[561]

d. The Care, Custody or Control Exclusion J(4)

The most common issue which arises under the care, custody and control exclusion is whether the property was in the control of the insured.[562] In the 1973 ISO policy, exclusion "k(3)" excluded *any property* in the care, custody or control of the insured. The parallel section in the 1986 ISO policy, exclusion "j(4)," excludes only personal property. In the 1986 revision, exclusion "j(4)" was limited to property in the custody of the *named* insured. In 1988, it was amended to exclude property in the custody of *any* insured.[563]

The 1998 revisions also eliminate the exclusion for property owned, occupied or loaned to the insured and personal property in the care, custody or control of the insured, where the property is rented to the insured for seven (7) days or fewer consecutive days.

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[560] *See Stull v. Am. States Ins. Co.*, 963 F. Supp. 492 (D. Md. 1997). For an excellent discussion of the alienated premises exclusion, see Patrick J. Wielinski and Jack P. Gibson, *Broad Form Property Damage Coverage* 9 (3d ed. IRMI 1992).

[561] *See, e.g., St. Paul Mercury Ins. Co. v. Fair Grounds Corp.*, Civ. A. No. 94-3861, 1996 WL 431102 (E.D. La. July 29, 1996) (applying loaned property exclusion).

[562] *See, e.g., Hartford Cas. Co v. Cruse*, 938 F.2d 601, 604 (5th Cir. 1991) (“care, custody or control” exclusion did not extend to entire home on which contractor performed faulty foundation work where homeowners lived in house while work was ongoing and never surrendered control to contractor) ; *Elcar Mobile Homes, Inc. v. D.K. Baxter, Inc.*, 169 A.2d 509, 516 (N.J. Super. 1961) (factors to be considered include whether the property is realty or personalty, its size, shape and other characteristics, what the insured is doing with it and how, and the interest in and relationship of the insured and others to it). *See generally* 7A J. Appleman, *Insurance Law and Practice* § 4493.03 (Berdal ed. 1979 & 2003 Cum. Supp.); Donald M. Zupanec, Annotation, *Scope of Clause Excluding From Contractor's or Similar Liability Policy Damage to Property in Care, Custody, or Control of Insured*, 8 A.L.R. 4th 563 (1981).

[563] *See, e.g., Nat’l Union Fire Ins. v. Structural Sys. Tech., Inc.*, 964 F.2d 759 (8th Cir. 1992) (television tower in care, custody and control of insured was real property and not within the exclusion).

e. That Particular Part Upon Which Operations Are Being Performed Exclusion – J(5)

Exclusion j(5) precludes coverage for damage to property on which the insured is actually working at the time of the loss.[564] The dispute concerning j(5) frequently centers on what "particular part" means, as that term is not defined. Since the property on which the insured is not working directly is not excluded, insureds seek to minimize the term and insurers seek to maximize it. The majority of courts that have addressed the issue give the exclusion a broad reading, including within the exclusion the entire piece of property on which the insured is working at the time of the occurrence.[565] The exclusion is limited to operations performed by "you," meaning the named insured. However, some courts have applied it to additional insureds.

f. The Faulty Workmanship Exclusion – J(6)

The exclusion eliminates coverage for the faulty workmanship of the insured.[566] Like exclusion j(5), it is limited to damage to "that particular part" of the damaged property. It is frequently applied to defective work by repairmen, such as, for example, where an electrical contractor, while working on an electrical panel, causes the building in which he is working to burn down. Of course, if the electrical contractor has completed his repairs, exclusion j(6) does not apply. The exclusion specifically excepts damage that occurs after operations are complete.[567] If the "property damage" occurs after operations are complete, the loss falls into the "completed operations hazard."[568]

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[564] *Harbor East-Office, LLC v. Travelers Cas. & Sur. Co.*, 201 F.3d 436 (Table), 1999 WL 672154 (4th Cir. Aug. 30, 1999) (foundation piles for building were "particular part" of property on which contractors were working); *Nationwide Mut. Ins. v. Regional Elec. Contractors, Inc.*, 111 Md. App. 80, 680 A.2d 547 (1996) (damage to switchboard) (dicta).

[565] *See, e.g., William Crawford, Inc. v. Travelers Ins. Co.*, 838 F. Supp. 157 (S.D. N.Y. 1993) (apartment); *Action Auto Stores, Inc. v. United Capitol Ins.* Co., 845 F. Supp. 417 (W.D. Mich. 1993) (gasoline containment system); *Am. Equity Ins. Co. v. Van Ginhoven*, 788 So.2d 388 (Fla. App. 2001) (swimming pool); *Jet Line Servs., Inc. v. Am. Employers Ins. Co.*, 537 N.E.2d 107, 111 (Mass. 1989) (petroleum storage tank); *Goldsberry Operating Co., Inc. v. Cassity, Inc.*, 367 So. 2d 133 (La. App. 1979) (well). *Cf. Vinsant Elec. Contractors v. Aetna Cas. & Sur. Co.*, 530 S.W.2d 76 (Tenn. 1975) (damage to switchboard shorted out by workman was excluded from coverage, but other damage did not fall within exclusion).

[566] *Nationwide Mut. Ins. v. Regional Elec. Contractors, Inc.*, 111 Md. App. 80, 680 A.2d 547 (1996) (dicta).

[567] *See, e.g., Action Auto Stores, Inc. v. United Capitol Ins. Co.*, 845 F. Supp. 417 (W.D. Mich. 1993).

[568] The "products completed operations" hazard is defined by the policy as including "bodily injury" and "property

Exclusion j(5) excludes coverage for "that particular part" of property on which work is being performed by or on behalf of the insured.[569] Exclusion j(6) excludes damage to "that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." These exclusions apply to the insured's defective work, the insured's non-defective work that is damaged by the faulty work,[570] and to consequential damages.[571] They do not apply to property damage to the work of others.

As noted above, disputes concerning j(5) and (6) frequently center on what "that particular part" means, because only the property on which the insured is directly working is excluded. Thus, insureds seek to minimize the term and insurers seek to maximize it. Most courts that have addressed the issue include within the exclusion the entire piece of property upon which the insured is working.[572]

In contrast, one commentator utilizes the following example:

> For example, consider an insured service contractor who, while repairing an air-conditioning unit for a customer, causes a short circuit that results in fire damage to the customer's home as well as the unit. The contractor will be covered for damage to the home but not to the air conditioner on which the contractor was working. In fact, the exception may go even further, excluding only the part of the air conditioner on which he was working.[573]

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damage" that occurs away from the insured's premises and arises out of the named insured's work or products.

[569] *See Harbor East-Office, LLC v. Travelers Cas. & Sur. Co.*, 201 F.3d 436 (Table), 1999 WL 672154 (4th Cir. Aug. 30, 1999).

[570] *See, e.g., Western Employers Ins. Co. v. Arciero & Sons, Inc.*, 194 Cal. Rptr. 688 (Cal. App. 1983).

[571] *See, e.g., Tobi Engineering, Inc. v. Nationwide Mut. Ins. Co.*, 574 N.E. 2d 160 (Ill. App. 1991).

[572] *See, e.g., Southwest Tank and Treater Mfg. Co. v. Mid-Continent*, 243 F. Supp. 2d 597, 604 (E.D. Tex. 2003) (steel storage tank); *Action Auto Stores, Inc. v. United Capitol Ins.* Co., 845 F. Supp. 417 (W.D. Mich. 1993) (gasoline containment system). *Cf. Vinsant Elec. Contractors v. Aetna Cas. & Sur. Co.*, 530 S.W.2d 76 (Tenn. 1975) (damage to switchboard shorted out by workman was not covered, but other damage did not fall within exclusion).

[573] Patrick J. Wielinski, *Insurance for Defective Construction,* at 137 (4th ed. IRMI 2000). *See also Economy Lumber Co. v. Ins. Co. of N. Am.*, 204 Cal. Rptr. 135 (Cal. App. 1984) (where the insured supplied defective siding that damaged several homes, the siding was excluded but not the loss of value to the homes); *Columbia Mut. Ins. Co. v. Schauf*, 967 S.W.2d 74 (Mo. 1998) (where insured hired to paint kitchen cabinets started fire that caused damage to the entire house, the only item of damage excluded from coverage was damage to the cabinets, which were "that particular part" of the property that was the subject of the insured's operations).

As mentioned above, many courts apply the exclusions broadly. For example, in *Lusalon, Inc. v. Hartford Accid. & Indem. Co*.,[574] the Court applied a predecessor exclusion ((y)(2)(d)(iii)) to find no coverage. Lusalon, a masonry subcontractor, while installing a concrete block, accidentally spattered mortar on adjacent window frames.[575] Instructed by the general contractor to clean the frames, Lusalon used cleaning fluid containing muriatic acid, and when the painting subcontractor painted the frames, the paint peeled.[576] The general contractor repaired the frames at a cost, and the issue in the declaratory action was whether Lusalon's insurer, Hartford, owed defense and indemnity for the general contractor's repair cost claim.[577] The Court held that the exclusion applied, rejecting Lusalon's contention that "that particular part of any property" referred exclusively to Lusalon's work product and did not extend to the surfaces of the frames.[578]

In *C. Walters Constr. Co., Inc. v. Fireman's Ins. Co. of Newark, N.J.,* [579] the policyholder, Walters, contracted with Giannelli to clear property for a roadway and excavate and prepare a pond on Giannelli's property. During the course of the project, Walters cut certain trees and dug a ditch against Giannelli's specific instructions. The Court applied a predecessor exclusion that barred coverage for "property damage … (2) to … (d) that particular part of any property …(i) upon which operations are being performed by or on behalf of the insured at the time of the property damage arising out of such operations."[580] The Court reasoned:

> The damage for which Walters seeks coverage involves property damage only to that particular part of Giannelli's property upon which operations were being performed by or on behalf of Walters at the time of the property damage arising out of Walters' operations. It does not involve accidental injury to other property. The alleged facts clearly subject each of Giannelli's

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[574] 511 N.E. 2d 595 (Mass. 1987).

[575] *Id*. at 596.

[576] *Id*.

[577] *Id*. at 597.

[578] *Id*.

[579] 316 S.E.2d 709 (S.C. App. 1984).

[580] *Id*. at 712.

causes of action to … [the] above quoted exclusion which, without qualification, denies coverage for property damage arising out of … the insured's-contractor's … faulty workmanship.[581]

J. BUSINESS RISK EXCLUSIONS – IN GENERAL

The term "business risk" does not appear in CGL policies, but it is an important concept. Liability insurers do not intend to insure the quality of their insureds' goods or services. Insurers intend only to insure risks outside the scope and control of the insured's operation. George Tinker may have said it best in his 1975 article on the then new 1973 ISO policy:

> It is not the function of the CGL policy to guarantee the technical competence and integrity of business management. The CGL policy does not serve as a performance bond, nor does it serve as a warranty of goods or services. It does not ordinarily contemplate coverage for losses which are normal, frequent, or predictable consequences of the business operations. Nor does it contemplate ordinary business expense, or injury and damage to others which results by intent or indifference . . . . "Business risks," then, are those risks which management can and should control or reduce to manageable proportions; risks which management cannot effectively avoid because of the nature of the business operations; and risks which relate to the repair or replacement of faulty work or products. These risks are a normal, foreseeable and expected incident of doing business and should be reflected in the price of the product or service rather than as a cost of insurance to be shared by others.[582]

There is no single "business risk" exclusion. Rather, it is a theme which runs through the policy. The insuring clause requires an "occurrence." Where the definition of occurrence requires an "accident," and that the injury be "neither expected nor intended from the standpoint of the insured," it eliminates the expected consequences of negligent acts.[583]

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[581] *Id.* (internal quotations omitted).

[582] George H. Tinker, *Comprehensive General Liability Insurance - - Perspective and Overview*, Fed'n. of Ins. Couns. Q., Vol. 25, No. 3, 215, 224 (Spring 1975).

[583] Although the "expected and intended" language was moved from the definition of "occurrence" to exclusion "a" in 1986, the function remains the same. *See Reliance v. Mogavero*, 640 F. Supp. 84, 86 (D. Md. 1986); *I.A. Constr. Corp. v. T & T Surveying, Inc.*, 822 F. Supp. 1213 (D. Md. 1993).

"Damages," as broadly defined by *Bausch & Lomb, supra,* means "money paid to make good an insured loss," or "anything that a third party can make you pay for because of damage to that third party's property."[584] This is distinct from good will payments which are sometimes urged by insurers to preserve their business image.[585] "Damages" also does not include fines, penalties, or assessments.[586]

The definition of "property damage" limits the scope of the policy to "physical injury to tangible property." Hence, losses for intangibles are not recoverable as "property damage." [587]

Exclusions (l) through (p) of the 1973 ISO policy exclude from coverage risks associated with the quality of property sold or work performed by the insured.[588] The 1986 ISO policy utilizes exclusions "j" through "m."

K. FAILURE TO PERFORM EXCLUSION

The "failure to perform" exclusion, like other business risk exclusions, is designed to prevent the insured from being subsidized for poor workmanship. Several courts applying Maryland law have analyzed the failure to perform exclusion, exclusion (m) of the 1973

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[584] *Bausch & Lomb*, 330 Md. at 781-82, 625 A.2d at 1032.

[585] The Exxon Valdez oil spill clean-up prompted more than 100 insurers to file a declaratory judgment action alleging that most of the more than one billion dollars spent were "good will" payments and hence not covered.

[586] *Bausch & Lomb*, 330 Md. at 782-83, 625 A.2d at 1033; Tinker, *supra* note 582, at 225.

[587] *See, e.g., Sting Sec. Inc. v. First Mercury Syndicate, Inc.*, 791 F. Supp. 555, 562 (D. Md. 1992) (Va. law) (lost profits, additional personnel costs, diminished capacity to generate new business and damage to business reputation are not "property damage"); *see also, e.g., Liberty Bank of Montana v. Travelers Indem. Co.*, 870 F.2d 1504, 1508-09 (9th Cir. 1989) (economic losses such as lost profits or good will are not considered property damage within the policy coverage); *Lassen Canyon Nursery v. Royal Ins. Co. of Am.*, 720 F.2d 1016 (9th Cir. 1983) (lost wages and benefits not "property damage"); *North Atlantic Cas. & Sur. Ins. Co. v. William D.*, 743 F. Supp. 1361, 1365 (N.D. Cal. 1990) (same); *Liberty Mut. Ins. Co. v. Consol. Milk Producers' Ass'n*, 354 F. Supp. 879 (D. N.H. 1973) (lost profits and good will are not "property damage"); *Peoples Tel. Co., Inc. v. Hartford Fire Ins. Co.*, 36 F. Supp. 2d 1335 (S.D. Fla. 1997) (loss of investments, anticipated profits, and financial interests); *St. Paul Fire & Marine Ins. Co. v. Nat'l Computer Sys., Inc*., 490 N.W.2d 626 (Minn. App.1992) (trade secrets); *Minn. Retail Systems, Inc. v. CNA Ins. Cos.*, 469 N.W.2d 735 (Minn. App.1991) (computer tape); *Hartford Acc. & Indem. Co. v. Case Foundation Co.*, 294 N.E.2d 7 (Ill. App. 1973) (investments, anticipated profits, and financial interests). *See generally* 9 *Couch on Insurance 3d* §126:35 (3d ed. 2003).

[588] *See* Tinker, *supra* note 582, at 224-25.

ISO policy.[589] It provides:

> This insurance does not apply:
> * * *
> (m) to loss of use of tangible property which has not been physically injured or destroyed resulting from
>
> (1) a delay in or lack of performance by or on behalf of the named insured of any contract or agreement, or
>
> (2) the failure of the named insured's products or work performed by or on behalf of the named insured to meet the level of performance, quality, fitness or durability warranted or represented by the named insured.
>
> but this exclusion does not apply to loss of use of other tangible property resulting from the sudden and accidental physical injury to or destruction of the named insured's products or work performed by or on behalf of the named insured after such products or work have been put to use by any person or organization other than an insured.

The purpose of this exclusion is to eliminate coverage for injury due to design and production errors where there is no "active malfunction of such products or work."[590]

In *Woodfin v. Harford Mut.*,[591] developers and the general contractor of a hotel filed a declaratory judgment action against the CGL insurer of the HVAC subcontractor for damages allegedly resulting from the subcontractor's faulty installation of the HVAC system. The damages claimed included the loss of income from the loss of use of guest rooms and the costs of repair and replacement of the HVAC system. The Court held that while the cost of repair and replacement of the HVAC system was within the ambit of exclusion (m), the loss of use of the guest rooms was not.[592] The loss of use fell directly

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[589] *See Reliance Ins. Co. v. Mogavero*, 640 F. Supp. 84, 87 (D. Md. 1986); *Woodfin v. Harford Mut.*, 110 Md. App. 616, 652-53, 678 A.2d 116, 133-34 (1996), *rev'd on other grounds*, 344 Md. 399 (1997); *Minnick's, Inc. v. Reliance Ins.*, 47 Md. App. 329, 422 A.2d 1028, 1030 (1980).

[590] 1966 ISO form exclusion (k).

[591] 110 Md. App. 616, 678 A.2d 116 (1996), *rev'd on other grounds*, 344 Md. 399 (1997).

[592] *Id*. at 651-52, 678 A.2d at 133.

within the exception to the exclusion for damage to the property of others.[593]

A similar loss-of-use claim, involving an analysis of the impaired property exclusion rather than the failure to perform exclusion, had a different result. In *Standard Fire Ins. Co. v. Chester-O'Donley & Assocs., Inc.*,[594] the named insured allegedly did not install duct work properly, causing problems with the HVAC system. Another contractor was brought in to replace the duct work. The Court concluded that the exclusion barred coverage for loss-of-use claims when the loss was caused solely by the insured's defective work, and where there has been no physical injury to property other than the insured's work. It concluded that the exclusion did not apply if there was damage to property other than the insured's work or if the insured's work could not be repaired without damaging other property.[595] Thus, the insured was required to provide a defense only with regard to claims based on physical injury to other property.[596] In its analysis, the Court cited two commentators who used the HVAC system problems as illustrations of the application of the "impaired property" exclusion:

> Say that the insured installs a heating and ventilation system in a new building. If the system later proves to be defective, resulting in the loss of use of the building while the system is being repaired or replaced, the insurer can cite the portion of the exclusion relating to "impaired property" in denying coverage for a resulting loss-of-use claim against its insured.
>
> Malecki & Flitner, [Commercial General Liability] at 52. Another text provides a similar, although more detailed, example:
>
> The completion of an office tower for DEVCORP was delayed by WARMCO's delay in completing its contract for the installation of heating, ventilation and air conditioning systems. When WARMCO informed GENERAL and DEVCORP that the heating system was completed and ready for use, it was determined that defects in the heating system

[593] *Id.* at 653, 678 A.2d at 133-34. The result should have been different under the "impaired property" exclusion. *See* Donald S. Malecki and Arthur L. Flitner, *Commercial General Liability 6*, at 63 (6th ed. 1997). *Cf. Commercial Union Ins. Co. v. F.H. Barto Co.*, 440 So.2d 383 (Fla. App. 1983) (holding that the "sudden and accidental physical injury" exception to the exclusion did not apply where the failure of the air conditioning system installed by the insured in an office building resulted in the owner's inability to rent the space).

[594] 972 S.W.2d 1 (Tenn. App. 1998).

[595] *Id*. at 9-10.

[596] *Id*.

> prevented the heating system from generating sufficient heat to meet the specifications. As a result, the office tower could not be occupied while repairs were made and DEVCORP suffered additional delays and substantial lost rental income. DEVCORP brought an action against GENERAL and WARMCO and GENERAL cross-claimed against WARMCO. Are the claims covered by WARMCO's CGL policy?
>
> Under this exclusion, there is no coverage for the claims against WARMCO because WARMCO's failure to perform resulted in delay and loss of use of property that had not been physically injured.
>
> Joseph G. Blute, Analyzing Liability Insurer Coverage for Construction Industry Property Damage Claims, available in WESTLAW, 7 No. 3 Coverage 1, 32 (American Bar Ass'n 1997).[597]

The application of the exclusion is illustrated in *Sting Sec., Inc. v. First Mercury Syndicate, Inc.*[598] There, the insured allegedly misrepresented the capabilities of its security system and as a consequence the underlying plaintiff alleged injury, claiming damages for "(1) the difference in value between the system promised and the negative value of [the security system]; (2) lost profits; (3) damage to [the insured's] business reputation; (4) additional personnel costs; and (5) costs associated with thefts directly attributable to the failure of [the security system]."[599] The Court held, *inter alia*, that exclusion (m) was not ambiguous as conflicting with the "completed operations hazard" and that exclusion (m) barred coverage for the failure of the security system to perform as warranted or represented.[600]

A leading out-of-state case explaining exclusion (m) is *Tobi Engin'g, Inc. v. Nationwide Mut. Ins. Co.*[601] Tobi delivered defective pads used in the construction of highways to AFCO, causing AFCO to become liable to the state of Louisiana for delay damages. Tobi's general liability insurer denied coverage based, *inter alia*, on the "failure to perform" exclusion, specifically (m)(1), *supra.* The Court held that the insured's failure

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[597] *Id*.

[598] 791 F. Supp. 555, 562-63 (D. Md. 1992) (Va. law).

[599] *Id*. at 558.

[600] *Id*. at 562-63.

[601] 574 N.E.2d 160 (Ill. App. 1991).

to make timely delivery of non-defective pads, resulting in delay damages, did not constitute "property damage" within the policy definition.[602] The Court observed that there was a symmetrical relationship between exclusion (m)(1) and whether the underlying claim is one for "physical injury to tangible property."[603] The definition of "property damage" has two prongs: "(1) [p]hysical injury to or destruction of tangible property . . . or (2) loss of use of tangible property which has not been physically injured or destroyed . . . ." Hence, if the type of property damage alleged is of the second type (loss of use), there will be no coverage if the loss of use is caused by delay or lack of performance by the named insured.[604]

L. IMPAIRED PROPERTY EXCLUSION

The 1986 ISO policy contains a parallel exclusion (m). It is designed to limit coverage for loss of use type property damage and diminution of value claims due to production or design errors that do not involve active malfunctions. It provides:

> This insurance does not apply to:
> * * *
> m. "Property damage" to "impaired property" or property that has not been physically injured, arising out of:
> (1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or
> (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.
>
> This exclusion does not apply to loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

At the time the exclusion was added, "impaired property" was a new concept. It is defined in the policy as follows:

> 5. "Impaired property" means tangible property, other than "your

[602] *Id*. at 164.

[603] *Id*. at 165.

[604] *Id*. at 164. Regarding the "failure to perform" exclusion, see generally *St. Paul Surplus Lines Ins. Co. v. Diversified Athletic Servs.*, 707 F. Supp. 1506 (N.D. Ill. 1989); *Am. Motorists Ins. Co. v. Trane Co.*, 544 F. Supp. 669 (W.D. Wis. 1982), *aff'd*, 718 F.2d 842 (7th Cir. 1983); *Aetna Cas. & Sur. Co. v. M&S Indus., Inc.*, 827 P.2d 321 (Wash. App. 1992).

product" or "your work," that cannot be used or is less useful because:

a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by:

a. The repair, replacement, adjustment or removal of "your product" or "your work;" or

b. Your fulfilling the terms of the contract or agreement.

The exclusion includes three types of property damage. The first is a form of impaired property, that is, property that incorporates the named insured's defective product or work. For example, the Space Shuttle Challenger was impaired property before the explosion, because it could not be used and it could be returned to use by replacing the O-rings. After the explosion, it was not "impaired property" because it could not be returned to use simply by replacing the O-rings.

The second type of property damage covered by the exclusion is also a form of impaired property, that is, property on which the named insured contracted to perform work, but either did not complete the work or performed faulty work.

These first two types of impaired property are excluded only if the damage can be rectified by the removal of the named insured's work or product or by properly performing the contract. For example, if the named insured subcontractor does not follow plans and specifications and installs the wrong windows in an office tower, causing them to randomly fall out, the problem can be resolved by replacing the windows.

A third type of property excluded is property that has not been physically injured, for example, a poorly constructed house or a building constructed on inadequate pilings.[605]

In *Chester-O'Donley & Assocs., supra,* the Court broke the "impaired property" exclusion into two parts:

[605] *See, e.g., Janecek v. Am. States Ins. Co.,* 480 N.W.2d 569 (Table, text in Westlaw), No. 91-1636 (Wis. App. 1991); *Harbor East-Office, LLC v. Travelers Cas. & Sur. Co.,* 201 F.3d 436 (Table), 1999 WL 672154 (4th Cir. Aug. 30, 1999) (Md. law).

> The effect of the "impaired property" exclusion is to bar coverage for loss of use claims (1) when the loss was caused solely by the insured's failure to provide work of the quality or performance capabilities called for by the contract and (2) when there has been no physical injury to property other than the insured's work itself. The exclusion does not apply if there is damage to property other than the insured's work or if the insured's work cannot be repaired or replaced without causing physical injury to other property.[606]

The purpose of the exclusion, therefore, is to limit loss-of-use claims.

A leading out-of-state decision explaining the operation of the new "impaired property" exclusion is *Transcontinental Ins. v. Ice Systems of Am.*[607] There, the Tampa Bay Lightning NHL franchise contracted with Ice Systems of America, Inc. (ISA) to set up a portable ice rink suitable for ice hockey. ISA set up a rink for an exhibition game to be played between the Boston Bruins and the Tampa Bay Lightning (TBL). The ice was too soft and the game had to be cancelled. TBL's insurer, Reliance, paid TBL for lost business damages and sued ISA.[608] The complaint sounded in breach of contract, alleging improper set up and installation of the ice rink, the electrical wiring, water lines, piping, and sealing of the plastic sheeting.[609] ISA's insurer, Transcontinental Insurance Co. (TCI), denied coverage.[610]

The Court began by reviewing the purpose of the exclusion: to prevent the insured from claiming economic losses resulting from the insured's work or work product.[611] The Court set out a three-part test:

> There are three rules regarding the applicability of exclusions such as Exclusion M. The first is that if the complaint fails to allege injury to other property, and merely alleges economic loss resulting from injury to the product itself, the exclusion is applicable. The second is that if the complaint

[606] 972 S.W.2d at 10 (citations omitted).

[607] 847 F. Supp. 947 (M.D. Fla. 1994).

[608] *Id*. at 948.

[609] *Id*. at 950.

[610] *Id*. at 948.

[611] *Id.* at 950.

> alleges or otherwise establishes damage to other property, Exclusion M will not apply. The third is that Exclusion M does not apply to situations arising from a sudden and accidental injury to the product which results in economic loss.[612]

The 1986 CGL policy's "impaired property" exclusion contains significant changes from the 1973 "failure to perform" exclusion. First, it excludes all property damage, not merely loss of use. The 1973 ISO exclusion applied only absent physical injury, which led to disputes as to whether there was physical injury where the only damage to tangible property was that it incorporated a defective component.[613] Second, the new language makes clear that diminution in value claims are not covered.[614]

Both the 1973 and 1986 versions of the exclusion have an exception for sudden and accidental physical injury to the insured's product or work. This exception depends on a factual determination as to whether the loss was sudden and accidental.[615] The "impaired property" exclusion has an exception for "loss of use of other property arising out of sudden and accidental physical injury to 'your product' or 'your work' after it has been put to its intended use." This exception to the exclusion is very similar to that contained in the "failure to perform" exclusion of the 1973 ISO CGL. Much of the litigation surrounding the "failure to perform" exclusion, and which is likely to surround the "impaired property" exclusion, focuses on the exception to the exclusion.[616]

M. DAMAGE TO PRODUCTS EXCLUSION

In the 1973 ISO policy, the "damage to products" or "own product" exclusion is found at exclusion (n):

> This insurance does not apply:

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[612] *Id*. (citations omitted).

[613] *See, e.g., Imperial Cas. & Indem. Co. v. High Concrete Structures, Inc.*, 858 F.2d 128 (3d Cir. 1988).

[614] See generally the discussion of property damage *supra* at § II C; Patrick J. Wielinski and Jack P. Gibson, *Broad Form Property Damage Coverage* (3d ed. IRMI 1992).

[615] *See, e.g., United Steel Fabricators, Inc. v. Fid. & Guar. Ins. Underwriters, Inc.*, No. 92AP-1171, 1993 WL 69258 (Ohio App. March 11, 1993); *see generally* Wielinski and Gibson, *supra* note 614, at 115-23.

[616] *See, e.g., Woodfin v. Harford Mut.*, 110 Md. App. 616, 678 A.2d 116 (1996), *rev'd on other grounds*, 344 Md. 399 (1997); *Commercial Union Ins. Co. v. F. H. Barto Co.*, 440 So. 2d 383 (Fla. App. 1983); *Baldt v. Am. Universal Ins. Co.*, 599 F. Supp. 955 (E.D. Pa. 1985); *Am. Int'l Underwriters Corp. v. Zurn Indus.*, 771 F. Supp. 690 (W.D. Pa. 1991).

* * *

(n) to property damage to the named insured's products arising out of such products or any part of such products.

Exclusion (n) was designed to exclude coverage for damage to a manufacturer's own products, but not to exclude coverage for damage to other property or injury to persons caused by a manufacturer's products.[617] While it was designed to apply to products, it has also been applied in the construction context.[618] The most complete analysis by a Maryland appellate court concerning exclusion (n) under the 1973 ISO policy is the 1996 case *Woodfin v. Harford Mut.* [619]

As discussed above, in *Woodfin*, developers and the general contractor of a hotel filed a declaratory judgment action against the CGL insurer of the HVAC subcontractor for damages allegedly resulting from the subcontractor's faulty installation of the HVAC system. The damages claimed included the loss of income from the loss of use of guest rooms and the costs of repair and replacement of the HVAC system. The Court held that the cost of repair and replacement of the HVAC system was excluded by the damage to products exclusion (n), but not the damages due to the loss of use of the guest suites.[620]

The appellants argued that because the system no longer belonged to the insured, it was not the insured's property; rather, it was third-party property, the property of the hotel. The Court rejected this argument, reasoning that the policy does not make a transfer of ownership distinction.[621] In fact, the policy's definition of "named insured's products" includes products that are "sold" by the insured. The policy defined "named insured's products" as "goods or products manufactured, sold, handled or distributed by the named insured . . . ."[622] Further, the Court held that because the insured was responsible for the entire HVAC system, the entire system was its "product."[623] It concluded, however, that

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[617] *See, e.g., Mayor and City Council v. Utica Mut. Ins. Co.*, 145 Md. App. 256, 802 A.2d 1070 (2002).

[618] *See, e.g., Mayor and City Council, supra*; *Century I Joint Venture v. U.S.F.&G.*, 63 Md. App. 545, 493 A.2d 370 (1985).

[619] 110 Md. App 616, 678 A.2d 116 (1996), *rev'd on other grounds*, 344 Md. 399 (1997) (discussed *supra* at § III concerning the definition of "property damage" and exclusion (m)).

[620] *Id.* at 659-60, 678 A.2d at 137.

[621] *Id*. at 650, 678 A.2d at 132.

[622] *Id.* at 650-51, 678 A.2d at 132-33.

[623] *Id.*

the exclusion did not apply to the claim for loss of use of the guest rooms, as they were not the insured's product.[624]

In a 2002 case, *Mut. Benefit Group v. Wise M. Bolt Co*., [625] the U.S. District Court for the District of Maryland construed a similar exclusion in a lawsuit by homeowners against their home builder, the insured. The applicable policy excluded coverage for damage to the insured's work. The insurer maintained that coverage was barred because the alleged damage was to the product of the insured, i.e., the house. [626] The Court noted, however, that the homeowners' complaint against the insured alleged damage not only to the house, but damage to other property, along with loss of use of the house.[627] The Court concluded that, under Maryland law, damage to other property and loss of use of the house because of the builder's negligent construction were "property damage" within the insured's CGL policy.[628] Thus, the exclusion did not relieve the insurer of the duty to defend the insured.[629]

In *Century I Joint Venture v. U.S.F.&G.*,[630] the Court of Special Appeals ruled that the "property damage to named insured's products" and "work performed by or on behalf of the named insured" exclusions precluded coverage for a condominium developer sued by condominium owners who alleged faulty design and construction. The Court held that based on the policy definition of "named insured's product" and

> [s]ince [the insured's] business consisted of the erection of a condominium building and the sale of individual condominium units therein, under a plain and ordinary interpretation of the exclusion, a condominium unit would be included within the definition "products . . . sold . . . by the named insured." . . . Similarly, we find that the Century I condominium building, although not "work performed by" appellants, was certainly work performed on their

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[624] *Id.* at 653, 678 A.2d at 134. Compare the result in *Woodfin, supra,* with the discussion of *Mogavero* and *I.A. Constr., supra*.

[625] 227 F. Supp. 2d 469 (D. Md. 2002).

[626] 227 F. Supp. 2d at 477.

[627] *Id.*

[628] *Id*. at 477.

[629] *Id*. at 477-78.

[630] 63 Md. App. 545, 493 A.2d 370 (1985).

> behalf. The [insureds], as developers of the condominium project, employed the architects and general contractor who actually designed and built the building, so the work was necessarily done on [the insured's] behalf.[631]

The Court, in its analysis, cites a law review article, Henderson, *Insurance Protection for Products Liability and Completed Operations—What Every Lawyer Should Know*[632] as follows:

> The risk intended to be insured is the possibility that the goods, products, or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable . . . . The coverage is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained.[633]

In *Century I*, there was no allegation of injury or damage to anything other than the condominium building. The insureds suffered a business loss, which was not a risk they bargained to insure. The Court rejected the argument that the exception to exclusion (a) (contractual liability exclusion) for breach of warranty creates a conflict with exclusions (n) and (o), rendering them ambiguous.[634] The Court stated that exclusionary clauses do not grant coverage; they limit the scope of coverage created in the insuring agreement.[635]

The 1986 ISO policy defines "your product" to specifically exclude real property. This definition was designed to avoid the result in *Century I*, *supra*, and similar cases as it pertains to exclusion (n).

Purchasing the Broad Form Property Damage Endorsement ("BFPD") expanded coverage by replacing exclusion (n) with more limited exclusions.

The 1986 Damage to Products Exclusion provides that the following is excluded

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[631] *Id*. at 555-56, 493 A.2d at 376 (citations omitted).

[632] 50 Neb. L. Rev. 415, 441 (1970).

[633] 63 Md. App. at 553, 493 A.2d at 375.

[634] *Id*. at 554-55, 493 A.2d at 376-77.

[635] *Id*. at 558, 493 A.2d at 377.

from coverage:

k. "Property damage" to "your product" arising out of it or any part of it.

The policy defines "your product" as:

a. Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:
(1) You;
(2) Others trading under your name; or
(3) A person or organization whose business or assets you have acquired; and
b. Containers (other than vehicles), materials, parts or equipment furnished in connection with such goods or products.

"Your product" includes warranties or representations made at any time with respect to the fitness, quality, durability or performance of any of the items included in a. and b. above.

"Your product" does not include vending machines or other property rented to or located for the use of others but not sold.

Coverage for the products hazard is designed to protect against liability for bodily injury or property damage arising out of the insured's products. It is not designed to insure against damage to the products themselves. The "damage to your products" exclusion is designed to accomplish this limitation.

The above definition of "your product" specifically excludes real property. The definition was amended in 1990 to include the providing or failure to provide warnings or instructions, to make clear that such claims fall under the products-completed operations hazard. By including warranties and representations in the definition, there is coverage for bodily injury or property damage resulting therefrom. This does not provide product warranty insurance.

N. WORK PERFORMED EXCLUSION

In the 1973 ISO policy, the "work performed" exclusion is found at exclusion (o).

This insurance does not apply:
* * *

(o) to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

This precluded coverage for workmanship risks. Exclusion (o) applies to damage while work is in progress and damage that occurs after work is completed. [636] Purchasing the Broad Form Property Damage Endorsement ("BFPD") expanded coverage by replacing exclusion (o) with more limited exclusions.

The most recent Maryland appellate decision concerning exclusion (n) under the 1973 ISO policy is *Woodfin v Harford Mut.*[637] As discussed above, in *Woodfin*, developers and the general contractor of a hotel filed a declaratory judgment action against the CGL insurer of the HVAC subcontractor for damages allegedly resulting from the subcontractor's faulty installation of the HVAC system. The damages claimed included the loss of income from the loss of use of guest rooms and the costs of repair and replacement of the HVAC system. The Court held that the cost of the repair and replacement of the HVAC system was excluded by exclusion (o), but not the damages due to the loss of use of the guest suites, as it was not the insured's work.[638]

In *Century I, supra*, the Court ruled that the "property damage" to "work performed by or on behalf of the named insured" exclusion precluded coverage for a condominium developer sued by condominium owners who alleged faulty design and construction. The Court reasoned, similarly, that the building, "although not 'work performed by' appellants, was certainly work performed on their behalf." [639]

In *Reliance v. Mogavero, supra*, the U.S. District Court for the District of Maryland addressed the issue of whether a general liability policy covered claims against a contractor for failing to use ordinary skill in performing a renovation. As a result of the contractor's faulty workmanship, the owner had to repair or replace the work done by the contractor at substantial expense. Apparently, all of the faulty work was performed by the named insured. The Court held that the policy did not afford coverage to the contractor because,

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[636] *See, e.g., Century I, supra; Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W. 229 (Minn. 1986); *Weedo v. Stone-E-Brick Ins.*, 405 A.2d 788 (N.J. 1979).

[637] 110 Md. App. 616 (1996), 678 A.2d 116, *rev'd on other grounds*, 344 Md. 399 (1997).

[638] *See also Mut. Benefit Group v. Wise M. Bolt Co., Inc.*, 227 F. Supp. 2d 469 (D. Md. 2002) discussed in §§ IIA and IIIB, *supra*.

[639] *Century I*, 63 Md. App. at 556, 493 A.2d at 376.

inter alia, the damages were excluded by exclusions (m) and (n). [640]

The 1986 "work performed" exclusion provides that the following is excluded from coverage:

> l. "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

The policy defines "your work" as follows:

> 15. "Your work" means:
> a. Work or operations performed by you or on your behalf; and
> b. Materials, parts or equipment furnished in connection with such work or operations.
>
> "Your work" includes warranties or representations made at any time with respect to the fitness, quality, durability or performance of any of the items included in a. or b. above.

The 1986 ISO "damage to your work" exclusion incorporates the broad form coverage. It excludes damage to work performed by the named insured.[641] There is an exception, however, for work performed by subcontractors.[642]

O. BROAD FORM PROPERTY DAMAGE ENDORSEMENT

The Broad Form Property Damage Endorsement ("BFPD") was offered as an endorsement to the 1973 ISO Comprehensive General Liability and earlier policies to broaden coverage for damage to property of others arising from the insured's work or in the

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[640] 640 F. Supp. at 87.

[641] *See Collett v. Ins. Co. of the West*, 75 Cal. Rptr. 2d 165, 167 (Cal. App. 1998).

[642] *See, e.g., Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Structural Sys. Tech.*, 964 F.2d 759 (8th Cir. 1992) (applying exception to work by subcontractor); *O'Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99, 104-05 (Minn. App. 1996) (same); *Kalchthaler v. Keller Constr. Co.*, 591 N.W.2d 169, 172 (Wis. App. 1999) (same).

insured's care custody and control.[643] It could be purchased with or without completed operations coverage. Generally, the BFPD eliminates both the "care, custody, and control" and the "injury to work performed" exclusions; i.e. (k) and (o). In their place, it substitutes new, less restrictive exclusions. The effect is to broaden the scope of property damage liability coverage.

The BFPD replaced the care, custody, and control exclusion (k) with more limited exclusions, *viz.*, property held for sale or entrusted to the insured for storage or safekeeping; property brought onto the insured's premises to have work performed upon it; tools and equipment while being used by the insured; and property for construction or installation which has been furnished to the insured. While none of these provisions specifically excludes real property, they do not by their nature apply to real property.

The work performed exclusion (o) was replaced in the BFPD by the following:

> This insurance does not apply:
> * * *
> (3) with respect to the completed operations hazard . . ., to property damage to work performed by the named insured arising out of such work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

This language includes a subtle change from the standard exclusion, *viz.*, "work performed by *or on behalf of* the named insured" is changed to "work performed by the named insured." The effect of this change was intended to provide coverage for damage to the work of the insured's subcontractors.[644] However, this change sparked extensive litigation with mixed results.[645]

The 1986 ISO form incorporates broad form property damage coverage, including completed operations, directly into the form. The 1986 ISO policy makes explicit the coverage of subcontractors' work.

The only cases applying Maryland law to the BFPD are *Minnick v. Reliance Ins. Co.*,

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[643] The Broad Form Property Damage Endorsement was first available in 1956. Wielinski and Gibson, *supra* note 614, at 3.

[644] *Id*. at 75 *et seq*.

[645] *Id.*

[646] *Harbor Court Assocs. v. Kiewit Constr. Co.,* [647] and *Reliance v. Mogavero.* [648] None of these three cases is particularly helpful in defining its coverage.[649]

P. PRODUCT RECALL OR SISTERSHIP EXCLUSION

The 1973 ISO CGL policy sistership exclusion was exclusion (p), which reads as follows:

> This insurance does not apply:
> * * *
> (p) to damages claimed for the withdrawal, inspection, repair, replacement, or loss of use of the named insured's products or work completed by or for the named insured or of any property of which such products or work form a part, if such products, work or property are withdrawn from the market or from use because of any known or suspected defect or deficiency therein.

The sistership exclusion takes its name "from the aircraft industry's practice of recalling planes for repairs when a 'sister ship'—a plane of the same model—has crashed because of a design defect."[650]

The product recall or sistership exclusion was intended to apply to the expenses of withdrawal, etc. of all similar products or work, and the resulting loss of use. Damage to property of others due to the failure of the product or work was not excluded. The policy does not explicitly exclude recalls initiated by vendors or other third persons (other than the manufacturer). So, for example, where the FDA initiated a recall because a buyer's vials of hormone suspensions were not sterile, a court held the sistership exclusion was not applicable.[651]

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[646] 47 Md. App. 329, 422 A.2d 1028 (1980).

[647] 6 F. Supp. 2d 449 (D. Md. 1998).

[648] 640 F. Supp. 84 (D. Md. 1986).

[649] *See generally* Wielinsky and Gibson, *supra* note 614.

[650] *Am. Motorists Ins. Co. v. The Trane Co.*, 544 F. Supp. 669, 694 (D. Wis. 1982).

[651] *Int'l Hormones, Inc. v. Safeco Ins. Co. of Am.*, 394 N.Y.S.2d 260 (App. Div. 1977). *See also Marathon Plastics, Inc. v. Int'l Ins. Co.*, 514 N.E.2d 479 (Ill. App. 1987), *appeal denied*, 522 N.E.2d 1246 (Ill. 1988); *Lipton v. Liberty Mut. Ins. Co.*, 314 N.E.2d 37 (N.Y. 1974) (noodle manufacturer's insurance policy covered its liability to soup company for soup

The 1986 ISO policy excludes sistership liability in exclusion "n," which excludes coverage for

> n. Damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:
> (1) "Your product";
> (2) "Your work;" or
> (3) "Impaired property";
> if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.
>
> Exclusion . . . n. do[es] not apply to damage by fire to premises rented to you. A separate limit of insurance applies to this coverage as described in SECTION III – LIMITS OF INSURANCE.

The 1986 exclusion contains two significant changes. First, the 1986 exclusion makes clear that the recall may have been ordered by the insured "or others." This is intended to avoid results such as in *Int'l Hormones*, *supra*, which limited the exclusion to costs incurred by the insured. Second, the exclusion's scope is expanded to apply to "impaired property," which makes the exclusion applicable to products in which the insured's product is a component part.[652]

Neither the 1973 nor the 1986 sistership exclusion was intended to apply to a product which has failed, "but only to a 'sister' product withdrawn after failure of the first product."[653]

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company's expenses incurred in withdrawing soup from the market because of alleged contamination of insured's noodles).

[652] *See* discussion, *supra* at § III M.

[653] *See, e.g., Am. Home Assur. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 29 (1st Cir. 1986) (sistership exclusion did not apply to windows which failed, but it did apply to windows which did not fail but were removed for replacement); *Charles E. Brohawn & Bros. v. Employers Commercial Union Ins. Co.*, 409 A.2d 1055, 1058 (Del. Super. 1979) (sistership exclusion applied to the costs incurred in replacing a concrete platform designed to hold an electric generator, when the defect in the platform was discovered before the platform was actually put to use). *See also Elco Indus., Inc. v. Liberty Mut. Ins. Co.*, 414 N.E.2d 41 (Ill. App. 1980) (exclusion (n) did not preclude coverage where replaced items were damaged); *The Yakima Cement Prods. Co. v. Great Am. Ins. Co.*, 590 P.2d 371, 374-75 (Wash. App. 1979) (exclusion did not bar coverage for repair costs to building damaged as a result of

Q. PERSONAL AND ADVERTISING INJURY EXCLUSION FROM COVERAGE A

The 1998 edition of the ISO CGL added an exclusion to Coverage A for personal and advertising injury coverage. It provides that the following is excluded:

> o. Personal And Advertising Injury
> "Bodily injury" arising out of "personal and advertising injury".

Hence, Coverage A provides no coverage for bodily injury arising out of any of the enumerated offenses within Coverage B.

R. ELECTRONIC DATA EXCLUSION

The 2004 ISO CGL added an electronic data exclusion as exclusion "p." It excludes coverage as follows:

> Damages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.
> As used in this exclusion, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.
> Exclusions c. through n. do not apply to damage by fire to premises while rented to you or temporarily occupied by you with permission of the owner. A separate limit of insurance applies to this coverage as described in Section III – Limits Of Insurance.

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integration of defective product); *Wyoming Sawmills, Inc. v. Transp. Ins. Co.*, 578 P.2d 1253 (Or. 1978) (exclusion did not bar coverage for cost of tearing out and replacing materials into which defective products had been integrated); *Gulf Ins. Co. v. Parker Prods., Inc.*, 498 S.W.2d 676 (Tex. 1973) (exclusion did not preclude coverage for loss of product rendered unfit for consumption as a result of integration of defective flavoring). *See generally* 7A J. Appleman § 4508.02 (Berdal ed. 1979, 2003 Cum. Supp.); Jean E. Maess, Annotation, *Validity and Construction of "Sistership" Clause of Product Liability Insurance Policy Excepting From Coverage Cost of Product Recall or Withdrawal of Product From Market*, 32 A.L.R. 4th 630 (1984).

The 2001 ISO CGL modified the definition of "property damage" to provide that electronic data was not "tangible property." The 2004 ISO CGL expressly excludes coverage for damages arising out of the loss of electronic data. This risk is excluded not because insurers do not wish to cover it, but because they wish to be paid for the increased risk. Policyholders may buy back part of this coverage through the Electronic Data Liability Endorsement CG 04 37, which provides coverage for damage to electronic data resulting from physical injury to tangible property. Broader coverage is available through Electronic Data Liability Coverage CG 00 65, which covers an "electronic data incident" causing "loss of electronic data." The definition of "loss of electronic data" tracks the new exclusion: it includes "damage to, loss of, loss of use of, corruption of, inability to access, or inability to properly manipulate electronic data."

S. PUNITIVE DAMAGES

It is not contrary to public policy for a liability insurance policy to cover punitive damages.[654] Punitive damages are covered under a standard liability policy that promises to indemnify the insured for "all sums" it is legally required to pay as damages.[655] Most CGL writers exclude punitive damages.

IV. CONDITIONS

A. NOTICE AND COOPERATION

Both the 1973 and the 1986 ISO policies require the insured to notify the insurer in the event of an "occurrence, claim or suit," and to cooperate in defending any claims or suits. However, an insurer's ability to disclaim for late notice or failure to cooperate is limited by Md. Code Ann., Insurance Article §19-110,[656] which reads in full, as follows:

> **§19-110 Disclaimers of coverage on liability policies**
>
> An insurer may disclaim coverage on a liability insurance policy on the ground that the insured or a person claiming the benefits of the policy through the insured has breached the policy by failing to cooperate with the

[654] *First Nat'l Bank v. Fidelity and Deposit Co.*, 283 Md. 228, 243, 389 A.2d 359, 367 (1978).

[655] *Alcolac, Inc. v. St. Paul Fire & Marine Ins. Co*., 716 F. Supp. 1541, 1545 (D. Md. 1989).

[656] Formerly Art. 48A, § 482, Annotated Code of Maryland.

> insurer or by not giving the insurer required notice only if the insurer establishes by a preponderance of the evidence that the lack of cooperation or notice has resulted in actual prejudice to the insurer.

This statute requires the liability insurer to prove "actual prejudice" before it can disclaim either its duty to defend or its duty to indemnify. Whether the insurer has suffered "actual prejudice" is a question of fact, not of law.[657]

What is the test for "actual prejudice"? The test has been evolving. In 1976, in *Harleysville Ins. Co. v. Rosenbaum*,[658] the Court of Special Appeals stated that:

> In order to show "actual prejudice," it is necessary to show an act on the part of the insured "which had or could have had any effect upon the jury which induced them or in any way caused them to render the verdict against himself." Stated another way, the *insurer must establish a substantial likelihood that if the cooperation or notice clause had not been breached, the insured would not have been held liable*.[659]

The *Harleysville* standard is not easy for insurers to meet. The insurer usually has a difficult time identifying a particular piece of evidence and/or a particular defense that it could have developed with proper notice or cooperation. If the insurer is able to do so, it must then convince the trier of fact that had that unknown piece of evidence or witness been available, there is a substantial likelihood that the insured would have prevailed at trial. This may be impossible to do in situations where the insured has refused to cooperate or has disappeared.

A markedly different theory was applied by the Court of Special Appeals in *Washington v. Federal Kemper Ins. Co.*[660] In that case, Washington contracted to build a house for William and Annie Lewis. The Lewises were dissatisfied with the completed house and sued Washington. Washington was served with the lawsuit on May 28, 1981. The case went to verdict in October 1982 resulting in a judgment of $11,616.07. Washington appealed. On November 9, 1982, Washington's attorney put Kemper on notice

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[657] *See, e.g., Harleysville Ins. Co. v. Rosenbaum*, 30 Md. App. 74, 351 A.2d 197 (1976).

[658] 30 Md. App. 74, 351 A.2d 197 (1976).

[659] *Id*. at 84, 351 A.2d at 202 (emphasis added) (dicta).

[660] 60 Md. App. 288, 482 A.2d 503 (1984).

of the suit and the appeal. Kemper denied coverage.[661]

The Court rejected the *Harleysville* standard (characterizing it as dicta) and noted that, in *Harleysville*, the Court ultimately concluded that the trial court's finding of no prejudice was premature because it was made before the trial of the underlying tort action.[662] The Court stated:

> We do not perceive that Art. 48A, §482 of the Maryland Code requires the insurance carrier to assume the burden of proving a negative. It is impossible for the carrier to demonstrate to the court what witnesses it might have discovered, what defense it might have made, and what disposition it might have reached in settlement if it had received notice before the verdict was rendered in this case.
>
> * * *
>
> In such cases where the insurer has been deprived of all opportunity to defend, the mere entry of the adverse judgment is affirmative evidence of actual prejudice to the insurer.[663]

Hence, the *Washington* Court took a more practical and less severe approach than the *Harleysville* Court. The *Washington* Court recognized that the insurer's "rights to investigate, evaluate coverage, choose defense counsel, and attempt to settle were substantial rights which were denied" by the insured's breach of contract.[664]

In *Allstate Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, [665] the Court of Appeals of Maryland considered the standard for determining prejudice under the Act. There, the State Farm insured initially gave her insurer's investigator an exculpatory statement regarding the automobile accident that gave rise to the underlying action. Later, she refused to cooperate in her defense, failing to appear for her twice-scheduled deposition, answer interrogatories or requests for production of documents or appear at trial. The

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[661] *Id*. at 290-91, 482 A.2d at 504.

[662] *Id*. at 295, 482 A.2d at 506.

[663] *Id*. at 295-96, 482 A.2d at 507.

[664] *Id*. at 294, 482 A.2d at 506. *See also INA v. Smith*, 197 Md. 160, 78 A.2d 461 (1951); *Nationwide v. U.S.F.&G.*, 304 A.2d 283 (D.C. 1973) (Md. law).

[665] 363 Md. 106, 127-30, 767 A.2d 831, 843-44 (2001).

trial court issued an order precluding her from introducing any evidence concerning the circumstances surrounding the accident.[666]

The Court rejected both the "substantial likelihood" approach of *Harleysville* and a "per se" approach based upon the insured's failure to cooperate or give notice, because of the many ways the issue may arise.[667] For example, the witness may give late notice, may give a statement and then fail to cooperate, or may fail to appear at trial. Where the insured fails to give prompt notice, whether it results in prejudice (i.e., lost opportunities "to discover relevant evidence, particularly the identity of witnesses and their contemporaneous recollections") usually cannot be known until trial.[668] Even then determining whether there was actual prejudice is somewhat speculative.[669] Where a disclaimer is based upon the insured's failure to appear at trial, the loss of the jury's ability to hear the insured's story from his own lips is potentially prejudicial. However, even then the credibility of the insured, and the availability of other witnesses and exhibits, must be weighed. Where the insured has given a statement prior to his failure to cooperate, "the nature of the lost evidence is known, and the uncertainty focuses on the effect and credibility of that evidence."[670]

The Court set forth the standard for assessing prejudice:

> [W]e believe that the proper focus should be on whether the insured's willful conduct has, or may reasonably have, precluded the insurer from establishing a legitimate jury issue of the insured's liability, either liability vel non or for the damages awarded.[671]

The Court also noted that:

> The prejudice was not in terms of how the jury would actually have viewed this evidence, whether the jury would have found it believable or not believable, for that is purely a matter of speculation. The prejudice lies in

[666] *Id*. at 112-13, 767 A.2d at 834-35.

[667] *Id*. at 126-28, 767 A.2d at 841-43.

[668] *Id*. at 124-25, 767 A.2d at 841.

[669] *Id.*, 767 A.2d at 841-42.

[670] *Id.* at 126, 767 A.2d at 842.

[671] *Id.* at 127-28, 767 A.2d at 843.

the fact that there was a credible defense to be presented and that [the insured's] non-cooperation precluded State Farm from even presenting that defense.[672]

[672] *Id*. at 129-30, 767 A.2d at 844. *See also Ball v. NCRIC, Inc*., 174 F. Supp. 2d 361 (D. Md. 2001).

1. Mere Delay Insufficient to Establish Prejudice *Per Se*

In *Gen. Accid. Ins. Co. v. Scott*,[673] the insured delayed twenty-nine months before notifying his underinsured motorist carrier of an accident. The insurer alleged that it suffered actual prejudice because it could not take "timely" statements from witnesses, photograph property damage, investigate the accident scene or participate in the decision to submit the case to arbitration.[674] The Court rejected these contentions. It reasoned that the insurer never alleged that it was unsuccessful in interviewing witnesses, that witnesses were unavailable, that witnesses' memories had failed or that the statements that had been obtained by others were insufficient.[675] Further, the Court rejected the insurer's contention that it could not investigate the scene, as it "made no claim that it ever attempted to investigate the accident, that important evidence was missing" and it failed to demonstrate that it was prejudiced as a result.[676] Further, the insured repeatedly offered to assist the insurer in its investigation, but the insurer declined.[677] Finally, the non-binding arbitration proceeding afforded the insurer access to the parties' discovery and claims by the parties.[678] Hence, the insurer had not demonstrated "actual prejudice."[679]

Two other Maryland cases, *Hartford Accid. v. Sherwood*[680] and *Woodfin v. Harford Mut.*,[681] further illustrate the need for evidence and the manner of proving prejudice for delayed notice of claim. In *Sherwood*, Osem, a worldwide food packager and distributor, sued Sherwood Brands ("Sherwood"), also a worldwide food packager and distributor, in North Carolina, alleging that Sherwood was distributing and marketing a soup package virtually identical in color, design, and graphics to a soup package used by Osem, with the

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[673] 107 Md. App. 603, 669 A.2d 773 (1996), *cert denied*, 342 Md. 115 (1996).

[674] *Id*. at 613, 669 A.2d at 778.

[675] *Id*. at 616, 669 A.2d at 779-80.

[676] *Id*. at 616-17, 669 A.2d at 780.

[677] *Id.* at 617, 669 A.2d at 780.

[678] *Id*. at 618, 669 A.2d at 780.

[679] *Id.* at 618-19, 669 A.2d at 781.

[680] 111 Md. App. 94, 680 A.2d 554 (1996).

[681] 110 Md. App. 616, 678 A.2d 116 (1996), *rev'd on other grounds*, 344 Md. 399 (1997).

intent to confuse the public and wrongly profit therefrom.[682] Two-and-one-half years later, Sherwood notified Hartford of the Osem litigation. Hartford later denied Sherwood coverage. Sherwood thereafter settled with Osem for $100,000.[683]

Sherwood sued Hartford in the Circuit Court for Montgomery County, claiming that Hartford wrongfully refused to provide a defense for Sherwood in the Osem litigation and wrongfully refused to indemnify Sherwood.[684] The trial court held that Hartford had a duty to defend Sherwood in the litigation; that Hartford, having shown no prejudice by the delayed notice, was responsible for Sherwood's pre-notice attorneys' fees; and that Hartford had a duty to indemnify.[685] The jury awarded Sherwood more than $497,000 in fees, costs, and expenses it incurred in the Osem litigation, as well as the $100,000 settlement; no pre-judgment interest was awarded.[686]

On appeal, the Court of Special Appeals held that in order for an insurer to disclaim coverage based on delayed notice of pending litigation, it must establish by a preponderance of the evidence that actual prejudice resulted therefrom.[687] Prejudice cannot be surmised or presumed from the mere fact of delay. The Court noted that Hartford "never stated specifically how the delay affected its investigation, other than that the matter was no longer 'fresh.' Significantly, [Hartford] does not claim that important information disappeared or that material evidence was no longer available."[688] Hartford's claim of prejudice was mitigated by the fact that Hartford received notification of the matter one-and-a-half years before the case went to trial, giving it ample time to investigate.[689] For these reasons, the Court concluded, the trial court was legally correct in finding that Hartford failed to show that it was actually prejudiced by Sherwood's delayed notification and in holding Hartford responsible for attorneys' fees incurred by Sherwood after the notification.[690]

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[682] 111 Md. App. at 100-01, 680 A.2d at 557.

[683] *Id*. at 102, 680 A.2d at 558.

[684] *Id*. at 99, 680 A.2d at 556-57.

[685] *Id*. at 102, 680 A.2d at 558.

[686] *Id*.

[687] *Id*. at 110-11, 680 A.2d at 562.

[688] *Id*. at 113, 680 A.2d at 563.

[689] *Id*.

[690] *Id. See generally* Stephen A. Klein, *Insurance Recovery of Prenotice Defense Costs*, 34 Tort & Ins. Law J. 1103 (Summer 1999).

In *Woodfin, supra*, the insurer was first notified of the possibility of an occurrence six years after the loss, four years after the tort suit was filed and two years after the entry of a judgment by default.[691] The tort case was proceeding against other defendants; thus, the default was an interlocutory judgment.[692] Further, the tort plaintiffs offered the insurer full access to their files and the insurer had an opportunity to petition the court to set aside the default judgment. The Court reasoned that prejudice may not be inferred from the mere passage of time.[693] The insurer acknowledged that it undertook no investigation into the facts of the case other than reviewing the underlying tort complaint.[694] The Court concluded that the trial court's factual finding of lack of prejudice would be affirmed.[695] However, as the case was remanded, the insurer would have an opportunity to present evidence of actual prejudice and lack of cooperation and notice.[696]

From these decisions, it is clear that prejudice will not be inferred even from the passage of several years. An insurer who wishes to disclaim coverage for lack of cooperation and late notice must build its case. It should go to the scene of the accident, take photographs of the scene and any physical evidence, attempt to locate and interview witnesses and otherwise investigate the loss. Even where there is a default judgment against the insured, the insurer should move to set it aside. In sum, the insurer should treat a late notice case like any other case from an investigative standpoint and document any prejudice which occurs. If no prejudice results, the insurer may not disclaim coverage.[697]

The statutory requirement for disclaimer of coverage does not usually apply to claims-made and reported policies. In *T.H.E. Ins. Co. v. P.T.P. Inc.*,[698] the Court of

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[691] 110 Md. App. at 656, 678 A.2d at 135.

[692] *Id.* at 657, 678 A.2d at 136.

[693] *Id.* at 658, 678 A.2d at 136.

[694] *Id.*

[695] *Id*.

[696] *Id.* at 659, 678 A.2d at 137.

[697] *See also Travelers Ins. Co. v. Godsey*, 260 Md. 669, 273 A.2d 431 (1971) (involving insured's failure to cooperate). *Cf. Commercial Union v. Porter Co.*, 97 Md. App. 442, 630 A.2d 261 (1993) (involving failure to give timely notice) (N.Y. law).

[698] 331 Md. 406, 628 A.2d 223 (1993).

Appeals held that the statute did not apply to a claim made against the insured after the policy had expired.[699] In *Med. Mut. Liab. Ins. Soc. of Md. v. Goldstein*,[700] the Court of Appeals considered when a claim is "made" in the context of a "claims-made" medical malpractice policy, concluding that an insurer properly denied coverage in connection with a suit against the insured where another claim arising out of the same incident had preceded the policy term.

B. OTHER CONDITIONS

1. Bankruptcy

The ISO CGL provides that the insurer's obligations under the policy are not cancelled by the insured's bankruptcy. The 1986, 1998, 2001 and 2004 versions[701] of the policy provide, in Section IV - Conditions:

> **1. Bankruptcy**
> Bankruptcy or insolvency of the insured or of the insured's estate will not relieve us of our obligations under this Coverage Part.

2. No Action Clause

The ISO CGL contains a no-action clause, which sets forth as a prerequisite to filing suit against the insurer to enforce the policy a requirement that the insured obtain written consent from the insurer prior to judgment or settlement. The 1986, 1998, 2001 and 2004 versions[702] contain the following provision:

> **3. Legal Action Against Us**
> No person or organization has a right under this Coverage Part:
> a. To join us as a party or otherwise bring us into a "suit" asking for damages from an insured; or

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[699] *Cf. St. Paul Fire & Marine Ins. Co. v. House*, 315 Md. 328, 554 A.2d 404 (1989). *See generally* Martin J. McMahon, *Event Triggering Liability Insurance Coverage as Occurring Within Period of Time Covered by Liability Insurance Policy Where Injury or Damage is Delayed—Modern Cases*, 14 A.L.R. 5th 695 (1993).

[700] 388 Md. 299, 879 A.2d 1025 (2005).

[701] The 1973 version contains similar language in the Conditions section, 5. Action Against Company.

[702] The 1973 version contains similar language in the Conditions section, 5. Action Against Company.

b. To sue us on this Coverage Part unless all of its terms have been fully complied with.

A person or organization may sue us to recover on an agreed settlement or on a final judgment against an insured; but we will not be liable for damages that are not payable under the terms of this Coverage Part or that are in excess of the applicable limit of insurance. An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative.

The purpose of the no-action clause, from the insurer's perspective, is to protect the insurer "from collusive or overly generous or unnecessary settlements by the insured at the expense of the insurer."[703] Under Maryland law, an insurer need not show that it was prejudiced when its defense to coverage is its insured's noncompliance with a no-action clause. In *Phillips Way, Inc. v. Am. Equity Ins. Co.*,[704] the Court of Special Appeals held that a no-action clause barred the insured's suit against the insurer whether or not the insured's prior settlement of the case without the insurer's permission prejudiced the insurer. In *Phillips Way*, an insured contractor brought an action against its professional liability insurer to recover money paid by the contractor to settle a defective construction claim.[705]

The insurer disclaimed coverage, arguing that a finding of prejudice was unnecessary because §19-110 of the Insurance Code did not apply to the no-action clause.[706] The Court agreed, noting that the statutory history supported the insurer's position and further noting that the notice and cooperation provisions were in separate paragraphs from the no-action provision.[707] The Court also observed that the purpose of the no-action clause (to prevent collusive settlements) "would be difficult to accomplish if an insured could disregard the no-action clause, sue its insurer, and put the nearly impossible burden on the latter of showing collusion or demonstrating, after the fact, the true worth of the settled claim."[708] It held, therefore, that the requirement of prejudice set forth in §19-

[703] 7 *Couch on Ins*. §105.7(3d ed. 1997).

[704] 143 Md. App. 515, 795 A.2d 216 (2002).

[705] *Id*. at 519, 795 A.2d at 218.

[706] *Id*.

[707] *Id*. at 522, 795 A.2d at 220.

[708] *Id*. at 524, 795 A.2d at 220-21.

110 was inapplicable "when an insurer defends on the basis that its insured failed to meet the condition precedent set forth in a no-action clause."[709]

3. Representations

The 1986, 1998, 2001 and 2004 versions[710] of the ISO CGL contain the following provision:

> **6. Representations**
> By accepting this policy, you agree:
> a. The statements in the Declarations are accurate and complete;
> b. Those statements are based upon representations you made to us; and
> c. We have issued this policy in reliance upon your representations.

An insurance policy is issued in reliance upon the insured's statements in the application. The Fourth Circuit has held that, under Maryland law, a policy of insurance "may be voided *ab initio* if it was issued in reliance on a material misrepresentation."[711] Further, an applicant for insurance will be held to representations made in the application which he or she has signed even if a third party filled out the application.[712] As long as the insured "has the means to ascertain that the application contains false statements, he is charged with the misrepresentations just as if he had actual knowledge of them and was a participant therein."[713]

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[709] *Id*., 795 A.2d at 221.

[710] The 1973 version of the ISO CGL contains the following provision:

> 12. Declarations. By acceptance of this policy, the named insured agrees that the statements in the declarations are his agreements and representations, that this policy is issued in reliance upon the truth of such representations and that this policy embodies all agreements existing between himself and the company or any of its agents relating to this insurance.

[711] *Scottsdale Ins. Co. v. Nat'l Center on Institutions and Alternatives*, 169 Fed. Appx. 176, 2006 WL 521734 (No. 05-1731, 4th Cir. March 3, 2006) (Md. law) (insured residential facility made material misrepresentation in application when it responded negatively to question concerning whether insured knew of any circumstances that may give rise to claim where insured failed to disclose choking incident that had left developmentally disabled adult in persistent vegetative state and that had been investigated by state agency).

[712] *Jackson v. Hartford Life and Annuity Ins. Co*., 201 F. Supp. 2d 506, 511 (D. Md. 2002) (life insurance application).

[713] *Id*.

A material misrepresentation is "one that may reasonably have affected the determination of the acceptability of the risk."[714]

4. Subrogation

A condition of the ISO CGL policy is that the insured's rights against third parties are transferred to the insurer once the insurer makes a payment on a claim. The insured must do nothing to impair that right after the loss and must assist the insurer in seeking recovery.

The 1973 policy form provides:

> 7. In the event of any payment under this policy the company shall be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights.

The 1986, 1993, 2001 and 2004 ISO policy forms provide:

> **8. Transfer Of Rights Of Recovery Against Others To Us**
> If the insured has rights to recover all or part of any payment we have made under this Coverage Part, those rights are transferred to us. The insured must do nothing after loss to impair them. At our request, the insured will bring "suit" or transfer those rights to us and help us enforce them.

5. Other Insurance Clause

The "Other Insurance" clause addresses situations in which more than one policy may cover the same risk. Such policies may be for concurrent or consecutive periods.[715]

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[714] *Id*. at 512 (quoting *N. Am. Specialty Ins. Co. v. Savage*, 977 F. Supp. 725, 728 (D. Md. 1997)). *See also Metropolitan Life Ins. Co. v. Samis*, 172 Md. 517, 192 A. 335, 340 (1937) ("The question . . . [is] whether the misrepresentations of the true facts would reasonably have affected the determination of the acceptability of the risk.").

[715] A small minority of courts look to "other insurance" clauses in both concurrent and consecutive policy situations. Maryland courts are among the majority, who rely upon the "other insurance" clause only in concurrent policy situations. For an analysis of how Maryland courts address consecutive policy situations, see Allocation discussion, *supra*, §II. D.1.c.

The ISO CGL contains the following "Other Insurance" provision:

4. Other Insurance

If other valid and collectible insurance is available to the insured for a loss we cover under Coverages **A** or **B** of this Coverage Part, our obligations are limited as follows:

a. Primary Insurance

This insurance is primary except when **b.** below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in **c.** below.

b. Excess Insurance

This insurance is excess over:
(1) Any of the other insurance, whether primary, excess, contingent or on any other basis;
(a) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work";
(b) That is Fire insurance for premises rented to you or temporarily occupied by you with permission of the owner;
(c) That is insurance purchased by you to cover your liability as a tenant for "property damage" to premises rented to you or temporarily occupied by you with permission of the owner; or
(d) If the loss arises out of the maintenance or use of aircraft, "autos" or watercraft to the extent not subject to Exclusion g. of Section I – Coverage A – Bodily Injury And Property Damage Liability.

(2) Any other primary insurance available to you covering liability for damages arising out of the premises or operations, or the products and completed operations, for which you have been added as an additional insured by attachment of an endorsement.

When this insurance is excess, we will have no duty under Coverages A or B to defend the insured against any "suit" if any other insurer has a duty to defend the insured against that "suit". If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.

When this insurance is excess over other insurance, we will pay only our share of the amount of the loss, if any, that exceeds the sum of:
(1) The total amount that all such other insurance would pay for the loss in the absence of this insurance; and
(2) The total of all deductible and self-insured amounts under all that other insurance.

We will share the remaining loss, if any, with any other insurance that is not described in this Excess Insurance provision and was not bought specifically to apply in excess of the Limits of Insurance shown in the Declarations of this Coverage Part.

c. Method Of Sharing

If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer's share is based on the ratio of its applicable limits of insurance of all insurers.

In cases with concurrent (overlapping) insurance policies, courts typically look to the "other insurance" clauses to determine allocation.

The court will first examine the language of the policies and determine which types of "other insurance" clauses are at issue. There are three common types: escape clauses, excess clauses, and pro rata clauses. [716]

Escape clauses are designed to prevent a policy from responding at all if there is other available insurance.[717]

[716] *See Consolidated Mut. Ins. Co. v. Bankers Ins. Co. of Pa.*, 244 Md. 392, 395-96, 223 A.2d 594, 596 (1966).

Excess clauses purport to make a policy excess to other available insurance.[718]

Pro rata clauses attempt to allocate the indemnity obligation among primary insurers based on the ratio of their policy limits to the total available coverage.[719]

After determining which types of clauses are at issue, the court will then attempt to reconcile the clauses, if possible. "This approach recognizes that the rights and liabilities of the different insurers involved should depend, as far as possible, upon the specific language of the policies."[720]

In a case involving two primary policies, one with a pro rata clause and one with an excess clause, the Court of Appeals has held that the excess clause takes precedence and is always given effect over the pro rata clause. Thus, the primary policy with the excess clause will be "excess" over the primary policy with the pro rata clause, notwithstanding the language of the pro rata clause allocating liability among all primary policies based upon policy limits. As a result, the policy with a pro rata clause will be primary, and must cover the loss up to its policy limits before the policy with the excess clause will respond.[721]

Similarly, when reconciling an escape clause and an excess clause, the Court has determined that the policy with the excess clause will serve as excess insurance to the policy with the escape clause. Thus, the policy with the escape clause will be primary, with the insurer obligated to provide coverage up to its policy limits before the policy with the excess clause is obligated to respond.[722]

When a court cannot reconcile competing clauses, it will equitably distribute the insurers' liability for the verdict. For example, when two excess clauses conflict, the Court of Appeals deems them to be mutually repugnant; thus, the insurers "stand on an equal footing [and] equity requires an equal apportionment" of the verdict.[723] Likewise,

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[717] *Id*.

[718] *Id*.

[719] *Id*.

[720] *Id*. at 396, 223 A.2d at 597.

[721] *Id*. at 399, 223 A.2d at 598.

[722] *Zurich Ins. Co. v. Continental Cas. Co.*, 239 Md. 421, 212 A.2d 96 (1965).

[723] *Ryder Truck Rental, Inc. v. Schapiro & Whitehouse, Inc.*, 259 Md. 354, 366, 269 A.2d 826, 832 (1970) (quoting *Cosmopolitan Mut. Ins. Co. v. Continental Cas. Co.*, 147 A.2d 529, 534 (N.J. 1959)).

when two pro rata clauses conflict, the Court treats the policies as concurrent insurance and each insurer is liable for its proportionate amount of the verdict.[724]

C. SEPARATION OF INSUREDS

The "separation of insureds" provision clarifies that the coverage analysis must be done separately for each insured. Its effect is as though a separate policy had been issued for each insured, although all the insureds draw on a common limit of liability.[725]

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[724] *Celina Mut. Cas. Co. of Ohio v. Citizens Cas. Co. of N.Y.*, 194 Md. 236, 245, 71 A.2d 20, 24 (1950).

[725] *Litz v. State Farm*, 346 Md. 217, 229-30, 695 A.2d 566, 572 (1997).