

The Hazards of Products and Completed Operations: Understanding the Fundamentals

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Even those who are relatively new to the insurance industry cannot help but be exposed to continual references to products liability or completed operations coverage. Unfortunately, any type of coherent explanation as to how this coverage actually works is usually lacking—say about as common as a Red Sox base-stealing threat.

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After all, liability coverage for products liability and completed operations liability insurance has been included in both the occurrence and claims-made Insurance Services Office, Inc. (ISO), commercial general liability (CGL) form for over 20 years—everyone knows it is there. So why pay it much heed?

Consider this—the most common reaction of an insurance professional who finally grasps the limitations of how the coverage applies is, "What good is it?" The second most common reaction is denial: "My companies don't pay claims that way." Even more interesting is the reaction of many clients' attorneys or accountants, or even of the clients themselves, when the fundamentals of this coverage are presented to them—some go as far as to suggest (or demand) a "tail." Others point out the how insurers try to weasel out of paying covered claims. Sorry, please try again!

Here is a litmus test that measures a basic understanding of what bodily injury or property damage will be covered within the products-completed operations hazard. Failure to grasp this deceptively simple concept will likely result in a fundamental misunderstanding of products and completed operations coverage.

An Example Illustrating the Harsh Reality

Consider an example. Dave's Decks has been installing high quality residential decks for the past 10 years. He is a sole proprietor with no employees and has done all the work himself. For the past decade, Dave has purchased through his insurance agent an occurrence-based ISO CGL policy (1985 edition or later) with no unusual endorsements. The policy has been in force continuously with the same insurance company for the past 10 years at a cost of about \$1,000 per year. Dave's CGL policy always included coverage for the products-completed operations hazard.

Dave has done quite well financially and decides to retire. He sends his policy back to his insurance agent for cancellation on July 1, 2006; the policy is terminated on that date as Dave has requested. Unfortunately, Mary, one of Dave's customers, is seriously injured when the deck she is standing on collapses on August 31, 2006. It is later found that in May 2006, when Dave built the deck, he forgot to properly fasten it to the wall. The collapse is the direct result of Dave's failure to fasten the deck to the wall. Mary's injuries are found to have been caused by the deck's collapse.

Mary brings suit against Dave who in turn submits the complaint to his insurer. Surely there is coverage, at least defense, for this mishap? Bear in mind, Dave has always purchased coverage for the products-completed operations hazard! But the harsh reality is that Dave's CGL insurer has no obligation to defend or respond in any way to the suit by Mary—Dave has no insurance for this claim. Why? Didn't Dave purchase products-completed operations coverage for all 10 years he was in business?

Here's the point—the CGL insuring agreement promises to pay *only* if bodily or property damage *occurs during the policy period*. While Dave did purchase products-completed operations coverage as part of his CGL policy, the injury to Mary occurred about 2 months *after his policy was terminated*. Products-completed operations coverage of the CGL is subject to and does not override this timing requirement—even if the bodily injury or property damage arises from the named insured's product or completed operation. Put another way, products-completed operations coverage does not *extend* the policy period—the policy *must* be in effect when the bodily injury or property damage occurs. It does not matter that, or even if, a CGL policy was in effect when Dave designed, built, or sold the deck. An occurrence-based CGL policy applies to the completed deck only if the bodily injury or property damage takes place during the policy period.

The supplemental extended reporting period (SERP) or "tail" that is sometimes offered as the solution to Dave's coverage gap simply doesn't work. First, the SERP or tail is not available on an occurrence CGL policy. Second, even if it was available, or if Dave had purchased a claims-made CGL policy and purchased the SERP, the SERP does not apply to bodily injury or property damage that *occurs during the tail or reporting period*. As the name suggests, the SERP only extends the CGL policy to include claims made against an insured during the extended reporting period that result from bodily injury or property damage *that took place when the policy was in effect*.

What if Dave continues to purchase a CGL policy for a period of time after retirement? As now may be obvious, this or a similar approach will close the coverage gap, at least for as long as Dave continues to renew his CGL policy. But, as seasoned practitioners know, purchasing coverage for a business that is no longer operating isn't that simple. While continuing Dave's CGL policy would provide the needed protection, insurers generally refuse to provide a CGL policy once it is disclosed that Dave has stopped building decks. Even the insurer that has provided Dave with CGL insurance for 10 years may decline to continue providing coverage for Dave's Decks once the business closes down.

This is in part due to ISO's withdrawal of the "Discontinued Operations" classification formerly available to insurers. Even though the exposure for Dave's Decks is actually *decreasing* during his retirement, the practical result is that Dave Deck's will likely have to seek CGL coverage in the nonadmitted marketplace, usually at a cost that is multiples of the premium paid when Dave was actively building decks. Nonetheless, CGL coverage must continue in force for Dave to have coverage.

The Products-Completed Operations Hazard—Important Considerations

Now that we have established a baseline understanding of the workings of products-completed operations coverage, it is important to consider several other situations in which a better understanding of exactly what is included in the "products-completed operations hazard" (which is a defined term in the CGL) is necessary.

Policy Limits

One of the six CGL limits is the products-completed operations aggregate limit. Knowing the types of claims that fall within and therefore reduce or exhaust this limit is critical.

Policy Exclusions

Several exclusions included *within* the CGL policy are tied directly to the products-completed operations hazard. For example, property damage exclusion j.(6), which eliminates coverage for the cost of restoring, repairing, or replacing the named insured's work that was incorrectly performed, does *not apply* to property damage that is included within the products-completed operations hazard. Exclusion l. eliminates property damage to your work if the property damage arises out of your work *and* is included within the products-completed operations hazard. In either case, whether the exclusion applies is dependent on whether the claim falls within the products-completed operations hazard.

Even certain bodily injury claims are eliminated if they fall within the products-completed operations hazard. Specifically, medical payments coverage expressly excludes any bodily injury included within the products-completed operations hazard.

Endorsement Excludes Products-Completed Operations Coverage

Based on the type of business or organization being provided CGL coverage, an insurer may exclude or the policyholder may choose not to purchase coverage for any bodily injury or property damage that falls within the products-completed operations hazard. In circumstances like these, it is crucial to understand precisely what coverage is being removed from the policy.

For example, in litigation that alleged liability on the part of handgun manufacturers and distributors for contributing to market overflow, the question before the court was whether such allegations fell within the products-completed operations hazard, as the policyholder's CGL policy excluded products-completed operations coverage. Market overflow was an assertion that manufacturers and distributors of handguns negligently created and supplied an unlawful national market in firearms, the source of the handguns that killed and wounded plaintiffs and their loved ones.

The policyholder asserted that the liability being alleged was covered even with the products-completed operations hazard exclusion because: (1) the products-completed operations hazard was intended to apply only to defective products claims; and (2) the actions do not allege actual injuries from the distributor's products but rather injuries from the company's management and strategy, thereby rendering the exclusion inapplicable.

The appeals court concluded that the allegations arose out of the policyholder's products and fell directly within the products-completed operations hazard exclusion. The court looked closely at the definition of the products-completed operations hazard and observed that wording applied to "*all* bodily injury and property damage occurring away from your premises and arising out of your product..." and that the proximate cause of the plaintiffs' injuries was firearms.

Only Products-Completed Operations Coverage Is Provided

For liability policies that are written specifically for a construction project, such as a consolidated insurance program (CIP) or "wrap-up," it is common to provide *full* CGL coverage for the period of the construction and then to provide products-completed operations *only* coverage for some period of time *after* construction is complete.

For example, in an owner controlled insurance plan (OCIP) (a type of CIP or wrap-up), the full CGL policy may be provided for a period of 24 months—the anticipated life of the construction—followed by extended products-completed operations *only* coverage for some additional period of time (36 to 120 months, depending on several factors, including the applicable statute of repose).

As everyone enrolled in the OCIP program (owner, general contractor, and subcontractors) is relying on the OCIP liability policy to provide them protection for the entire project, including liability that may result from injuries or damage arising out of completed work, fully comprehending the specifics of what is included within the products-completed operations hazard is vital.

The Products-Completed Operations Hazard—An Overview

As previously mentioned, products-completed operations hazard is a defined term and is found in the definitions section of the CGL policy.

Must Occur Away from Your Premises. To be included within the products-completed operations hazard, the bodily injury or property damage must occur away from premises owned or rented by the named insured *and* arise out of "your product" or "your work." Said differently, bodily injury or property damage that takes place on the named insured premises is not within the products-completed operations hazard (this can be amended by endorsement, however). Second, the bodily injury or property damage must arise out of "your product" or "your work," terms also defined in the CGL.

Your Product. A broadly defined term, this includes goods or products manufactured, sold, handled, distributed, or disposed of by the named insured, others trading under the named insured's name, and includes a person or organization whose business assets a named insured has acquired. Your product includes containers (but not vehicles), materials, parts, or equipment used or furnished in connection with goods or services, but does not include any real property.

Your Product—Warranties. For those insurers who routinely break out the boilerplate "the CGL never provides coverage for any breach of contract claim," take note—the definition of your product specifically includes warranties and representations made with respect to the fitness, quality, durability, performance, or use of your product.

Black's Dictionary (Seventh Edition) states:

- **Warranty**
- 2. *Contracts.* An express or implied promise that something in furtherance of the contract is guaranteed by one of the contracting parties; esp. the seller's promise that the thing being sold is as represented or warranted.

Breach of warranty is a contract theory of liability, not a tort theory. Claims that allege a product caused bodily injury or property damage because of a breach of warranty are asserting a breach of contract claim. Breach of warranty claims, while subject to other policy terms and conditions, cannot be dismissed simply because the theory of liability being put forth is breach on contract. The CGL policy plainly intends to include breach of warranty claims in the definition of your product. In addition to warranties, your product also includes providing or failing to provide warnings.

Not Your Product. Vending machines or *other property* rented to or located for use of others but not sold are not considered your product. For example, a hardware store rents chainsaws to homeowners for their personal use. If the homeowner is injured when using the chainsaw because the hardware store failed to properly maintain the equipment, the homeowner's claim against the hardware store is not considered a claim that will fall within the products-completed operations hazard as the injury did not arise out of your product.

Your Work. Similarly, "your work" is a broadly defined term and includes operations performed by the named insured or on the named insured's behalf, including material, parts, or equipment in connection with the operations. Operations or work performed on behalf of the named insured means that work done by a subcontractor is still considered your work.

Also similar to your product, the definition of your work includes warranties and representations made with respect to the fitness, quality, durability, performance, or use of your work as well as providing or failure to provide warnings or instructions. The breach of contract issue raised above applies in the same manner to your work as it does to your product.

Not Products-Completed Operations Hazard

Physical Possession. Products still in the named insured's possession are not included in the products-completed operations hazard. In other words, for a claim to be within the products-completed operations hazard, the named insured has to have given up physical possession and the injury or damage must take place away from the named insured's premises. In most cases, bodily injury or property damage caused by a product that takes place on the insured's premises or that takes place while the product is still within the possession of an insured would be considered a premises or operations claim.

Completed Work. The products-completed operations hazard does not apply if the work has not yet been completed or abandoned. The work is considered by the policy definition to be completed the *earlier* of:

1. When *all* the named insured's work as required in a contract has been finished.
2. When all the work at a job site has been completed if the named insured's contract requires work under the same contract but at another job site.

For example, Chris's Cooling has a contract to repair the air-conditioning systems for The Real Estate Group at three different office buildings. Once Chris has completed the repair of the air-conditioning equipment at the first location, that job is considered to be complete. Thus, any bodily injury or property damage that may arise from that first location is included within the products-completed operations hazard, even if the other two jobs are not finished.

3. When that part of the work done at a job has been put to its intended use by someone other than another contractor or subcontractor working on the same project.

An example: Bill's Builders is constructing a 3-story building that is intended to be sold as 20 residential condominium units. Even though construction is still ongoing for a majority of the units, three units are sold and occupied by the owners. Bodily injury or property damage that may arise out of the three occupied units would be considered to fall within the definition of products-completed operations hazard as the units have been put to their intended use—residential housing. The remainder of the condominium project would not be considered completed as all the work has not been completed and there is only one site for this project.

Service or Repair Work. An important and often confused clarification of what constitutes completed work follows the above three-part completed work test. The CGL policy states that work is considered complete even if the completed work (as defined above) may need subsequent service, maintenance, repair, or replacement. For instance, if in the above example, Bill's Builders has to go back and repair one of the occupied units to fix doors that are not properly hung, the CGL makes clear that the unit is still considered completed work. Bodily injury or property damage that arises from the finished unit will be included within the products-completed operations hazard.

It is, however, important to point out that the products-completed operations hazard *does not apply* to an injury to the unit owner that occurs while Bill is actually in the unit adjusting the doors. Say Bill's ladder falls over and hits the unit owner while Bill is working on the doors—this injury to the unit owner is an operations claim and not a products-completed operations claim. In other words, this paragraph does not mean (as is too often assumed) that performing operations on completed work is the same as completed work.

While this may seem inconsequential, it can become a major coverage issue when the *only coverage* provided to a contractor is products-completed operations coverage, which is commonly the case in consolidated insurance programs or wrap-ups. Insurers who regularly provide wrap-up liability coverage generally recognize that a contractor or subcontractor may have a warranty period in which they are obligated to go back to perform service or repair work and thus amend their CGL policy accordingly. For example, an insurer may extend the policy term to provide limited operations liability coverage beyond the policy expiration for bodily injury or property damage that takes place while certain contractors are performing required repair work during the warranty period.

Other Situations Not Considered Included within the Products-Completed Operations Hazard

Transportation of Property. Transporting property is generally not considered to fall within the products-completed operation hazard. An illustration: a manufacturer of plastic resin engages a common carrier to transport its product (the plastic resin) to distributors. During the trip, some of the resins escape from the common carrier's trailer onto the highway, causing very slippery conditions that result in auto accidents and injuries to motorists. As the resin is the product of the manufacturer, resulting claims against the manufacturer would otherwise be within the products-completed operations hazard. To keep such claims within the general aggregate limit, the policy removes from the definition of products-completed operations hazard the transportation of property.

A noted exception to the above is a claim that is caused by the improper or negligent loading or unloading of a vehicle that is not owned or operated by the named insured. In this instance, the loading or unloading (and not the transportation) of the property is considered a completed operation. For example, a contractor overloads a common carrier's truck with sand and gravel, resulting in the small stones flying out of the truck and injuring pedestrians. This bodily injury claim would be considered to fall within the products-completed operations hazard from the standpoint of the contractor who overloaded the truck.

Tools and Equipment. Bodily injury or property damage that is caused by tools, *uninstalled* equipment or abandoned or *unused* materials is not included within the products-completed operations hazard.

Included in General Aggregate Limit. Certain CGL classifications specifically note that products and completed operations are included, such as the classification Buildings or Premises—Office—Not-for-Profit Class Code: 61227 NOC (not otherwise classified). No separate premium charge is made for products-completed operations hazard for such businesses or organizations (any charge is included within the premises and operations premium) and thus any claims that would otherwise be considered products or completed operations claims are considered premises and operations claims and thus reduce the general aggregate limit.

On occasion the "products/completed operations included" classification seems to cause confusion; some insurers contend that the intent of this classification wording is to *eliminate coverage entirely* for any claim that arises out of your product or your work. Of course, this wording does not reduce coverage; it merely states that the products-completed operations hazard does not include such claims—it does not say that *no coverage* applies to such claims.

Restaurants and Other Food Vendors. The ISO Classification Table requires that an endorsement be attached to the CGL policy for certain classifications, such a restaurant, to change the definition of products-completed operations hazard. The required endorsement is the Products-Completed Operations Hazard Redefined (CG 24 07) which changes the definition by removing the requirement that bodily injury or property damage take place *away from the named insureds' premises* for the claim to be included within the products-completed operations hazard. The intent is to consider food consumed on the premises to be included within the products-completed operations hazard (and within the products-completed operations aggregate limit). Therefore, a claim by a customer alleging food poisoning resulting from a meal consumed at Chef's Best Restaurant will be included within the restaurant's CGL products-completed operations hazard despite the fact the bodily injury from food poisoning took place on the restaurant's premises.

As with the "products/completed operations included" classifications, some insurers wrongly contend that the Products-Completed Operations Hazard Redefined endorsement eliminates coverage for any bodily injury or property damage that arises out of the restaurant's products. A careful reading of the endorsement reveals that the definition of products-completed operations has been expanded to include bodily injury or property damage that arises out of your products, even if the bodily injury or property damage takes place on the premises of the insured (in this case the premises of the restaurant).

Conclusion

The coverage provided for products and completed operations in the standard CGL policy seems to get short shrift. Too little attention is paid to the basics of how the coverage works within the context of the entire policy—including the requirement that any bodily injury or property damage, even if caused by an insured's product or completed work, must take place during the policy period for coverage to apply. It is only after this deceptively simple concept is fully understood can the more specific issues that surround the "products-completed operations hazard" be appreciated—such as how the products-completed operations hazard affects policy exclusions and restricts coverage endorsements.

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