The Increasingly Complex CGL Policy

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"The CGL policy covers what it covers," *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d (Tex. 2007). Indeed.

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Without context, this state Supreme Court's statement seems to beg the question. Yet, that such a deceptively simple commentary on the Insurance Services Office, Inc. (ISO), commercial general liability policy was deemed necessary is quite revealing. Put another way, why wouldn't the CGL policy cover what it covers? Why does the obvious need to be stated?

Here are some not so obvious matters to decipher and consider as ever-changing complexities of the CGL policy. While matters of similar concern are far more numerous than mentioned here, this may be a good place to begin to further develop an appreciation for why insurance was infamously described as a "flood of darkness."

Coverage A—Insuring Agreement

Coverage A of the CGL begins with a broad grant of coverage—the promises made by the insurer to those afforded the status of insured. Of course, limitations to the insurer's promises are foreshadowed by the phrase "…to which this insurance applies." What becomes evident is that a string of exclusions follow which will substantially refine the original promise. Not as readily apparent, but also of significance, is that some exclusions incorporate exceptions, i.e., short narratives outlining situations when the exclusion *does not remove coverage*.

Burden Shifting—Insuring Agreement

At the outset, the insured has the burden of demonstrating that the allegations or claim against it fall within the scope of the insuring agreement.[1] For example, Coverage A of the CGL policy provides coverage only for bodily injury or property damage caused by an occurrence. If allegations against an insured do not allege or constitute bodily injury or property damage, terms defined by the CGL policy, the insured would have failed to sustain its burden, and the CGL policy would provide no coverage. Similarly, even if allegations are for bodily injury or property damage, no coverage is provided unless the bodily injury or property damage is caused by an occurrence, a term also defined in the CGL policy.

For example, consider a situation in which a sprinkler contractor misreads the applicable building codes and installs an automatic sprinkler system in a new building only to have the building owner make a claim against the contractor for the cost of bringing the system up to code. The cost to the contractor to tear out and replace the sprinkler system would most likely not be considered property damage—physical injury to tangible property—and, thus, the contractor would not have coverage under the CGL policy.

It is worthy of emphasis that CGL policy does not apply in the example because the claim did not trigger the insuring agreement and *not* because the CGL policy excludes the claim. Should the contractor litigate, presuming the trial judge found the costs being claimed against the contractor did not amount to property damage, the inquiry would end there.

Exclusions and exceptions to the exclusions have no relevance and would not be considered in such a determination.

Exclusions Do Not Create Coverage

This leads to the oft-repeated mantra that "exclusions do not create coverage." An exception to an exclusion may appear to grant coverage, but it is nonetheless derived from an exclusion. And it is not possible for an exclusion (or its exception) to broaden the initial insuring agreement, only limit or restrict it.

Nevertheless, the "exclusions do not create coverage" principle does not negate the well-settled and equally important principle that the CGL policy must be read as a whole, giving effect to all of the policy terms and conditions. For instance, a complete review of all of the CGL policy may provide a court a better understanding of the breadth or scope of the insuring agreement. Considering the entire policy, which necessarily includes all exclusions, to improve the court's grasp of the insuring agreement simply does not violate the "exclusions do not create coverage" battle cry.[2]

To illustrate, it is often contended that the CGL insuring agreement is meant to pay damages *solely* for the tort liability of an insured. That an insured's obligation to pay damages by reason of an insured's assumption of liability in a contract or agreement is excluded (with two significant exceptions) makes plain that the insuring agreement does include coverage for at least some liability undertaken in a contract.

Burden Shifting—Exclusions

Once the insured does demonstrate the allegations or claim is within the scope of the CGL insuring agreement, the burden shifts to the insurer to prove the allegations or claim is within an exclusion. In some instances, this burden may be a difficult one, as courts tend to read exclusionary wording narrowly and construe exclusions strictly.

Burden Shifting—Exceptions to Exclusions

In some jurisdictions, the burden is on the insured to show an exception to the exclusion "carves out" or brings the claim or allegations back within coverage. Consider the illustration above. If an insured is obligated to contractually indemnify another for that other person's tort liability to a third person, the burden is on the insured to demonstrate an exception to the contractual liability exclusion applies—including that the liability assumed was in an "insured contract," and the bodily injury or property damage took place after executing the indemnification agreement.

Occurrence

Although it is undisputed that "occurrence" is a defined term in the CGL policy,[3] exactly what constitutes an "accident" is hotly disputed. Litigation over construction defects, which involves multiple coverage issues, is often focused on the meaning of "accident" within the definition of "occurrence." That the battle over construction defects is being waged within the insuring agreement is, however, no accident.

Simply stated, if a court can be persuaded to hold that faulty workmanship can *never* be accidental, then exclusions and exceptions to those exclusions are rendered meaningless. Bear in mind that if the claim does not fall within the initial coverage grant, the CGL policy affords no coverage; the rest of the policy wording is irrelevant.

It is no secret, then, that the effect of such a holding is to wipe out the subcontractor exception to the property damage to "your work" exclusion.[4]

Fortuity—An Expanded View

Consider a recent unanimous decision of the highest court in the *Commonwealth of Kentucky in Cincinnati Ins. Co. v. Motorists Mut. Ins. Co.*, 306 S.W.3d.69 (Ky. 2010). After concluding that the term "accident" must be given its plain meaning, the court noted that it was compelled to take into account that "the full nature of the concept of fortuity" as an "accident" is actually about the doctrine of fortuity, and that the court had not "fully explored its [fortuity's] breadth and scope":

In short, fortuity consists of two central aspects, intent, which we have discussed in earlier opinions, *and control*, which we have not previously discussed. [Emphasis added.]

After rightly observing that the policy only covers occurrences that are accidents, the court concluded, "one cannot intend to commit an accident because an accident is 'an event that takes places without one's foresight or expectation….'" But, the court reasoned, considering intent alone was insufficient—control must also be considered:

Or, in other words, a court must bear in mind that a fortuitous event is one that is "*beyond the power of any human being to bring…to pass* [or is]…within the control of third persons…." It is abundantly clear, therefore, that the issue of control is encompassed in fortuity. [Emphasis added.]

While the above statement was made within the context of construction defects, there is nothing in this rather startling holding that suggests that the court does not intend to apply its view of fortuity to any and all situations involving the CGL policy.

Control is very often an essential element in ordinary negligence; events that are "beyond the power of any human being to bring to pass" cannot be reconciled with the duty to exercise reasonable care. Put another way, it is the *conduct* of a person that is the measure of negligence.[5] Surely, the very notion of control is inherent in determining a person's conduct or exercise of due care.

While the Supreme Court of Kentucky may well assert the CGL policy will apply to certain claims of ordinary negligence, the logical implications of the court's expanded view of fortuity strongly indicate otherwise.

Some Courts Differ

Tennessee

The consequences of this highly restrictive definition of an "accident" within the CGL policy have been recognized by other courts. For example, in Kentucky's neighbor state, the Supreme Court of Tennessee made the following observation in *Travelers Indem. Co. v. Moore & Assocs. Inc.*, 216 S.W.3d 302 (Tenn. 2007):

Holding that a negligent act does not constitute an "accident" is inconsistent with our previous holding that an "accident" may include the negligent acts of the insured. Other courts have observed that *construing an accident in a manner that does not cover the insured's negligence would render a CGL almost meaningless*. We decline to adopt a construction of "accident" which so drastically limits the coverage under a CGL. [Emphasis added.]

Indiana

To explain the fundamental flaw and obvious inconsistencies in the narrow characterization of an "accident," the Indiana Supreme Court provided the following illustration in *Sheehan Constr. Co. v. Continental Cas. Co.*, 935 N.E.2d 160 (Ind. 2010), actually taken from the above Tennessee Supreme Court's opinion:

[I]f a contractor improperly installs a shingle that later falls and hits a passerby, this event is unforeseeable and is an "occurrence" or "accident." . . . A shingle falling and injuring a person is a natural consequence of an improperly installed shingle just as water damage is a natural consequence of an improperly installed window. If we assume that either the shingle or the window installation will be completed negligently, it is foreseeable that damages will result. If, however, we assume that the installation of both the shingle and the window will be completed properly, then neither the falling shingle nor the water penetration is foreseeable, and both events are "accidents."

Texas

Similarly, in *Lamar Homes, supra*, the Supreme Court of Texas noted:

… faulty workmanship that damages the property of a third party is a covered "occurrence," whereas faulty workmanship that damages the property of the insured contractor is not. The logical basis for the distinction between damage to the work itself (not caused by an occurrence) and damage to collateral property (caused by an occurrence) is less than clear. Both types of property damage are caused by the same thing–negligent or defective work. One type of damage is no more accidental than the other.

Legislation

Finally, at least one state legislature took exception to court imposed restrictions on the definition of "accident" within the CGL policy for the construction industry. The General Assembly of the State of Colorado enacted a statute "Concerning Commercial Liability Insurance Policies Issued to Construction Professionals" that states in pertinent part:

In interpreting a liability insurance policy issued to a construction professional, a court shall presume that work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured.

Causation

According to press reports, on March 28, 2007, three people were killed in a Houston office building fire. The arsonist, a nurse who also worked in the building, pleaded guilty to three counts of felony murder and one count of first degree arson, and was sentenced to 25 years in prison.

On December 17, 2008, the *Houston Chronicle* reported (also picked up by the Associated Press) that the insurer providing excess liability insurance to the building owners was attempting to deny coverage to the building owners for the wrongful death complaints made by the families of the deceased. As the deaths were caused by smoke inhalation, the insurer was arguing to the judge the pollution exclusion applied—as the bodily injury was caused by smoke, fumes, or soot—all pollutants as defined in the policy.

Because of the national attention this situation commanded, many within the law and insurance industry spoke out against the insurer's coverage denial. One national commentator argued that the pollution exclusion should not apply as pollution was not the *proximate cause*[6] of the deaths, asserting that the "but for"[7] wording ("bodily injury or property damage which would not have occurred in whole or in part *but for* the actual, alleged, or threatened discharge, dispersal, seepage, migration, release or escape of pollutants at any time.") found in the pollution exclusion endorsement required proximate causation for the exclusion to apply.

The Importance of Causation

Normally a concern within the framework of property insurance, the issue of causation also holds great import for liability insurance (for more on causation, see The Enigma of Causation in Insurance Contract Interpretation by Kenneth S. Wollner). Consider the Texas case above—if the wording in an exclusion requires a causal link, consideration of causation is imperative to evaluate the link in order to determine the meaning of the exclusion.

Phrases such as "caused by" and "resulting from" are significant to coverage interpretation. A commonly used phrase, particularly in CGL exclusionary wording, is the phrase "arising out of." Even though causation is important to CGL exclusionary wording, the implications of causation also extend to coverage grants. For example, personal and advertising injury is defined to mean injury *arising out of* the listed offenses.

Arising Out of

Courts have generally interpreted "arising out of" to be broader than proximate cause, more like "but for" causation.[8] In some situations, a minimal causal connection will be sufficient. *See Vitton Constr. Co., Inc. v. Pacific Ins. Co.*, 110 Cal. App. 4th 762 (2003). However, such abstract parameters lend little to a practical understanding.

A common interpretation is for "arise out of" to mean "originating from," "growing out of," or having a "substantial nexus." *See Flomerfelt v. Cardiello*, 997 A.2d 991 (N.J. 2010). There, the Supreme Court of New Jersey commented that:

Each of those potential definitions includes a causal link between the excluded act and the injury, but none requires that the excluded act be the proximate cause of the injury. Indeed, we specifically commented that other courts had interpreted the phrase to imply a connection weaker than proximate cause.

In reconsidering its own ruling that exclusions using "arising out of" were clear and unambiguous, the court realized that such a phrase, when attempting to apply "originating from," "growing out of," or having a "substantial nexus" may be ambiguous when presented with certain circumstances.

Wendy Flomerfelt sustained injuries, including kidney and liver failure, when she overdosed on a combination of alcohol and drugs during a party hosted by Matthew Cardiello. Ms. Flomerfelt alleged her injuries were caused by Mr. Cardiello when he provided her with drugs and alcohol even though she was visibly intoxicated. She alleged that Mr. Cardiello also failed to summon help when she was found unconscious.

The insurer for Cardiello's parent's homeowner insurance denied liability coverage based on its exclusion for claims "arising out of the use…transfer or possession of controlled substances." As Ms. Flomerfelt's injuries involved potentially multiple and concurrent causes (drugs, alcohol, and failure to summon help) the court deemed "originate from" or "grow out of" to mean both a

close causal connection and a temporal relationship. For the exclusion to apply, her injuries must have *begun* with the use of drugs at the party. Any injury from drugs used before the party or injury from alcohol would not be excluded, as such injury did not "originate from or grow out of" the use of controlled substances.

The court further determined that having a "substantial nexus" was broader and could result in excluding her injuries if drug use was *part* of the concurrent causes; that a "substantial nexus" may still be found even if there were other contributing causes to her injuries. But if the use of drugs before she arrived at the party caused her injuries, or a prior drug history caused her injuries, the party could not be considered a "substantial nexus" to her injuries and thus the claim would not be excluded. Similarly, if alcohol were to be found to be the cause of her injuries, there would be no "substantial nexus" and her injuries would not "arise out of" the use of a controlled substance and thus not be excluded.

Limits to "Arising out of"

The insurer urged the court to read the phrase "arising out of" to mean "incident to" or "in connection with." However, by rejecting the insurer's expansive reading of "arising out of," the court effectively imposed bounds on the notion of "minimal causal connection or incidental relationship," and also declined to allow a limitless "but for" theory of causation:

That reading would expand the phrase "arising out of" to mean that the injury is connected in any fashion, however remote or tangential, to the excluded act, rather than one that "originates in," "grows out of," or has a "substantial nexus" to the excluded act. It is a suggested reading so at odds with our caselaw that we decline to embrace it.

Finally, the court held that, given the facts of the case, and without further qualification of the exclusion, the phrase "arising out of" made the exclusion ambiguous, requiring an interpretation consistent with the insured's reasonable expectations.

Conclusion

Awareness of some rather obscure yet important coverage issues, such as the required degree of fortuity or the role of causation in coverage interpretation, is critical to understanding the workings of the CGL policy. Recognition of the various courts' diametrically opposed interpretation of the meaning of precisely the same wording may be exasperating, but is also instructive.

The Texas Supreme Court's statement, "the CGL policy covers what it covers," summarily dismissed the commonly held suggestion that a CGL policy is transformed into a performance bond to the extent faulty work is considered an occurrence. The court explained that coverage is not eliminated in the CGL policy because similar protection may be available in another insurance product. Further, the court noted in detail why a performance bond and the CGL policy serve fundamentally different purposes and why insurance cannot morph into a performance bond.

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[1]This is a general discussion only with no attempt to distinguish between the duty of the insurer to defend an insured and the obligation to pay damages on behalf of the insured.

[2]"A court need only ask why the CGL policy includes an exclusion for property damage to the insured's work and that of its subcontractors to understand that it would be nonsensical for the policy to include such a provision if this kind of property damage could never be caused by an "occurrence" in the first place." Clifford Shapiro, "The

Good, the Bad, and the Ugly: New State Supreme Court Decisions Address Whether an Inadvertent Construction Defect is an "Occurrence" under CGL Policies," *25 Constr. Law Summer*, 2005.

[3]"Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. CG 00 01 12 07 © ISO Properties, Inc. 2006.

[4]It is not the writer's view that property damage to "your work" is always covered by the CGL—merely that faulty work *may* be accidental and that CGL policy exclusions directly address such issues.

[5]**Negligence.** The failure to exercise the standard of care that a reasonably prudent person would have exercised in similar situation; any conduct that falls below the legal standard established to protect others against unreasonable risk of harm… *Black's Law Dictionary*, 8th edition (St. Paul, MN: West Group, 1999).

[6]**Proximate cause.** A cause that directly produces an event and without which the event would not have occurred. Black's Law Dictionary, 8th edition (St. Paul, MN: West Group, 1999).

[7]**But-for cause.** The cause without which the event could not have occurred. *Black's Law Dictionary*, 8th edition (St. Paul, MN: West Group, 1999).

[8]The phrase "arising out of" must be read expansively, incorporating a greater range of causation than encompassed by proximate cause under tort law. . . . Indeed, cases interpreting the phrase "arising out of" in insurance exclusionary provisions suggest a causation more analogous to "but for" causation . . . *Bagley v. Monticello Ins. Co.*, 430 Mass. 454, 457 (1999).

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