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## The Meaning of Loss of Use in The Definition of Property Damage

By Rhonda D. Orin \*

In most analyses of third party commercial and comprehensive general liability ("CGL") insurance policies, questions invariably arise about the meaning of the definition of property damage. Such questions arise because the policies typically cover "damages" incurred because of "property damage." Thus, for there to be insurance coverage under these liability policies, there first must be a finding of "property damage."

Under standard form policies, there is no doubt that actual, physical injury to property is a form of "property damage." See, e.g., *Stauffer Chemical Co. v. Insurance Co. of North America*, 372 F. Supp. 1303 (S.D.N.Y. 1973); *Elco Industries, Inc. v. Liberty Mutual Ins. Co.*, 90 Ill. App. 3d 1106, 414 N.E.2d 41 (1980). A different, and harder, question, however, is whether there is property damage without physical injury to property. Courts and commentators are at times confused, about whether the definition of "property damage" is satisfied when the only "damage" caused to any property is the loss of use of property which has not been physically injured.

Loss of use occurs whenever there is an interruption to the normal use of property. This interruption may be caused by a tangible, physical blockage of access to the property, see *Continental Casualty Co. v. Gilbane Bldg. Co.*, 391 Mass. 143, 461 N.E.2d 209 (1984) (property damage found when falling glass from building barred access to restaurant in building), or by other events which prevent the property from being used, see *Sola Basic Indus., Inc. v. United States Fidelity & Guaranty Co.*, 90 Wis. 2d 641, 280 N.W.2d 211 (1979) (property damage found when removal of defective equipment rendered plant unusable). The unifying factor in these cases is that the property in question is physically untouched but, nevertheless, cannot be used.

The drafting history of the definition of property damage makes clear that from 1966 to today, loss of use always has been and still is property damage. Unfortunately, the clear intent of the insurance industry representatives who drafted various standard form definitions of property damage has not always been understood.

### A. The 1966 CGL Policy

The 1966 standard form definition of property damage states:

"Property damage" means injury to or destruction of tangible property.

No reference to loss of use is contained in this definition. The drafting history of this definition, however, shows that the policy drafters fully intended this definition to include loss of use. The only reason the definition does not so state is that the policy drafters determined that a direct reference in the definition to loss of use was not necessary.

An early draft of the property damage definition made physical injury a requirement of property damage, thus eliminating loss of use as property damage. In 1961, the Joint Forms Committee to the Rating Committees of the National and Mutual Bureaus, which was a committee of policy drafters, proposed defining property damage as

physical injury to or destruction of tangible property.

See Explanatory Memorandum of the Joint Forms Committee, May 4, 1961.

The Joint Forms Committee abandoned this proposal precisely because this proposal, in requiring physical injury, prevented loss of use without physical injury from constituting property damage. To make clear that loss of use without physical injury constitutes property damage, the Committee deleted the word "physical" from the proposed definition. In approving this deletion, the Committee explained:

Thus the intent is clarified that the injury or destruction must be to "tangible" property but such property need not be physically damaged, e.g. the damages sustained by the closing down of a building would be within the definition.

See *id.* (emphasis supplied).

\*Rhonda D. Orin is a partner in the New York and Washington, D.C. law firm Anderson Kill Olick & Oshinsky, P.C., which regularly represents policyholders in insurance coverage disputes. The assistance of legal assistant Laurie Baldinger is gratefully acknowledged.

In 1966, William J. Obrist, of the General Accident Group, wrote an article analyzing the new policy form. With regard to the definition of property damage, Mr. Obrist stated:

The new definition omits any requirement of physical injury as a prerequisite for coverage. The National Bureau states that *the policy will cover the insured's legal liability if no specific exclusion applies even though the tangible property is not physically damaged but is made useless by the act of an insured.* An example would be the breaking down of a large piece of contractor's equipment on a public street in such a manner that the street must be closed off for a period of time and the public has limited or no access to the stores located in the block affected.

Obrist, *New Comprehensive General Liability Insurance Policy* (1966), reprinted as Appendix C to Defense Research Institute, *General Liability Insurance-1973 Revisions* (Vol. 1974, No. 1, Jan. 1974) (emphasis supplied). See also Nachman, *The New Policy Provisions for General Liability Insurance*, *The CPCU Annals* 197, 200 (1965) (since definition does not require physical injury, "if the insured's crane buckles and the street must be closed off, loss of use claims from business owners on the street would be covered"). See also Brain, *Changes and Possible Problems In The New Liability Policy*, *Mid-America Insurance* (July 1966).

The policy drafters created an opportunity for confusion when they failed to place a direct reference to loss of use in the definition of property damage. Taken alone, the words "injury to or destruction of tangible property" did not necessarily include loss of use (although certainly loss of use was not precluded, as it would have been if the policy drafters had not eliminated the modifier "physical").

Unfortunately, the policy drafters turned the mere possibility of confusion into a virtual guarantee when they made an unrelated change, which also happened to involve the words "loss of use". That change was the specific inclusion of the words "loss of use" in the definition of damages. The 1966 standard form insurance policy defines damages as follows:

"Damages" includes . . . damages for loss of use of property resulting from property damage.

The direct reference to loss of use made clear that loss of use is a form of damages that can be collected when there is insurance coverage.

The policy drafters apparently did not expect the inclusion of loss of use in the definition of damages to

cause confusion in the interpretation of the definition of property damage. As understood by the policy drafters, loss of use has two entirely separate meanings for purposes of insurance coverage. On the one hand, loss of use constitutes a form of property damage which can trigger coverage in the absence of physical injury to tangible property. On the other hand, loss of use is a form of damages that may be collected when there is insurance coverage. Thus, there could be insurance coverage for losses incurred by a restaurant that is forced to shut down (loss of use as damages) because falling glass from windows above the restaurant caused the street in front of the restaurant to be closed (loss of use as property damage). See *Continental Casualty Co. v. Gilbane Bldg. Co.*, 391 Mass. 143, 461 N.E.2d 209 (1984). Since the policy drafters clearly understood loss of use to have such separate meanings, the policy drafters apparently did not anticipate that their intentions might be misunderstood.

The policy drafters would have been well advised to specify their intentions more clearly. Because they did not do so, confusion occurred. For example, many courts and commentators understood that loss of use constituted property damage even though the definition of property damage did not so specify. See, e.g., *American Motorists Ins. Co. v. Trane Co.*, 544 F. Supp. 669, 682-83 (W.D. Wis. 1982) (plant's decreased operating capacity is "property damage"), *aff'd*, 718 F.2d 842 (7th Cir. 1983); *Cute-Togs of New Orleans, Inc. v. Louisiana Health Serv. & Indem. Co.*, 376 So. 2d 999 (La. Ct. App. 1979), *rev'd on other grounds*, 386 So. 2d 87 (1980) (machinery's lost use is "property damage"); 3 R. Long, *Law of Liability Insurance* § 6 at 38 app. (rev. ed. 1974).

Some courts and commentators, however, concluded erroneously that loss of use did not also constitute property damage. See, e.g., *Dreis & Krump Mfg. Co. v. Phoenix Ins. Co.*, 548 F.2d 681, 687 (7th Cir. 1977) (uselessness of housing structure resulting from brake's defectiveness not "property damage"; "actual" injury required); *Willeys Point Contracting Corp. v. Hartford Ins. Group*, 75 A.D.2d 254, 258-59, 429 N.Y.S.2d 230, 233 (2d Dep't 1980); *aff'd*, 53 N.Y.2d 879, 440 N.Y.S.2d 619, 423 N.E.2d 42 (1981) (business's lost use through wrongful access blockage not property damage under 1966 policy); Tarpey, *The New Comprehensive Policy: Some of the Changes*, 33 *Ins. Coms. J.* 223, 227 (1966); Tinker, *Comprehensive General Liability Insurance-Perspective and Overview*, 25 *Fed. Ins. Couns. Q.* 217, 232-33 (1975); Arness & Eliason, *Insurance Coverage for Property Damage in Asbestos and Other Toxic Tort*

*Cases*, 72 Va. L. Rev. 943, 957-61 (1986) ("Although loss of use is . . . one measure of the damages an insurer may be responsible to pay under such a policy, as damages because of property damage, it is not property damage in and of itself and thus, it does not trigger coverage").

The result was a split in decisions regarding the proper interpretation of property damage.

**B. The 1973 CGL Policy**

The insurance industry undertook to eradicate this confusion when it revised the standard form CGL policy in 1973. That revision included a significant clarification in the property damage definition. The 1973 policy defined property damage as meaning:

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

Under subsection (1) of this definition, coverage would not attach unless the property in question was physically injured or destroyed. Under subsection (2), however, coverage would attach when there was loss of use of property even without physical injury or destruction. This definition therefore added the specific reference to loss of use that was missing from the 1966 definition of property damage.

The Defense Research Institute, in a 1974 analysis of the 1973 revisions, provided two illustrations of loss of use coverage under subsection (2):

(1) The insured contractor engaged in road repairs, damages a gas main, requiring that the gas be shut off. As a result of the interruption of the gas service, a plant served by the lateral from the gas main must temporarily shut down. The "loss of use" claim would be covered even though none of the "tangible property" of the plant has been damaged.

(2) The insured's crane buckles and blocks the entrance to a building. The claim for "loss of use" of the building would be covered.

See Defense Research Institute, *General Liability Insurance-1973 Revisions* (Vol. 1974 No. 1 January 1974). These examples are substantially similar to the examples chosen by the 1966 drafters to illustrate the intent of the 1966 policy. The similarity in illustrations confirms that the 1973 revisions merely clarified, and did not change, the meaning of the 1966 policy.

The 1973 revision also eliminated the definition of damages that was found in the 1966 policy and left damages as an undefined term. According to the F.C.& S. Bulletins, the definition of damages was no longer needed because its terms had been incorporated into other sections of the revised policy. For example, the reference in the former definition of damages to "loss of use of property resulting from property damage" was incorporated into subsection (1) of the revised property damage definition. Subsection (1) of the revised property damage definition now included "the loss of use thereof resulting therefrom." See F.C.& S. Bulletins, *General Liability Changes* (1973); Comments of Richard H. Elliott, of the Insurance Services Offices, on the 1973 General Liability Policy Revision, attached to letter to WAIB-IBA (Committee on Revised Liability Forms, September 22, 1972) ("The reference to 'loss of use' of property present in the definition of damages is transferred to the new definition of 'property damage'...").

Due to this revision, loss of use in subsection (1) actually refers to the consequential damages which may result from physical injury to or destruction of tangible property. See, e.g., Letter from David B. Edwards, Counsel to Aetna Fire & Casualty Co., to Robert F. Bauer, vice president of Johnson & Higgins, (Dec. 18, 1972) (confirming Bauer's belief that loss of use under subsection (1) "should fall within consequential loss covered by the policy"); Annotated Copy of Umbrella Excess Liability Policy released by Liberty Mutual Insurance Co. in July 1973 (interpreting subsection (1) as meaning that "the policy in force at the time of the physical injury also cover[s] consequential damage including subsequent loss of use arising from this incident").

An interesting argument can be made about why the reference to loss of use in the damages definition was transferred to the property damage definition. The argument is that the reference was transferred to make clear that when loss of use results from physical injury, such loss of use cannot fall thereafter under subsection (2) of the property damage definition. Specifically, loss of use which results from physical injury cannot fall under subsection (2) even if the loss of use extends beyond the policy period in which the physical injury took place. In such a case, the trigger is the physical injury which gave rise to the loss of use.

Theoretically at least, loss of use which results from physical injury could have fallen under subsection (2) of the revised definition if the loss of use took place in a policy period in which there was no physical injury. Thus, loss of use which resulted from physical

injury, but which extended beyond the policy period in which the physical injury took place, could have fallen under subsection (2). However, the reference to loss of use in subsection (1) eliminated this possibility. The words "including the loss of use thereof resulting therefrom" made clear that when loss of use results from physical injury, such loss of use falls only under the scope of subsection (1).

The drafting history of the 1973 definition of property damage supports the above argument. Specifically, the Joint Conference Subcommittee originally proposed amending the 1966 definition to read:

property damage means physical injury to or destruction of or loss of use of tangible property.

Joint Conference Subcommittee Meeting, Minutes (February 18, 1970). Another committee approved this proposed definition on the basis that the proposal would clarify the 1966 intent to include loss of use as property damage. General Liability Governing Committee Meeting, Minutes (March 17, 1970). The Joint Forms Committee, however, refined the proposed definition further, ending up with the two-part definition which ultimately was adopted. The Committee explained that the further refinement had been necessary to prevent confusion about which policy period was in effect when loss of use resulting from physical injury extends over more than one policy period. The Committee offered this example:

If a building is physically injured in Policy A and has resultant loss of use extending over Policy A and later Policy B, all of the damages would be covered under Policy A.

Joint Forms Committee Meeting, Minutes (August 4 & 5, 1970).

As explained by Robert P. Cook, assistant general attorney at Liberty Mutual Insurance Company:

In the new property damage definition, we divide the concept into 2 parts: the first, physical injury along with all resulting loss of use: the second, pure loss of use of tangible property which has not been physically injured. . . Then, as to the first category - where there is physical injury - we telescope all resulting loss of use back to the time of the physical injury.

See Address by Cook, *Contemplated Changes In General Liability Coverage*, Mutual Insurance Technical Conference in Philadelphia, Pa. (November 18, 1970). The same result is achieved in subsection (2) due to the requirement that the loss of use must be caused by an occurrence during the policy period,

unless the physical injury or the occurrence itself was continuous. In such case, each policy in force during the continuous physical injury or the continuous occurrence should pay for loss of use. See *id.*

### C. The 1986 CGL Policy

In 1986, the standard form CGL was revised yet again. The new form defines property damage as follows:

- (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.

This definition is substantially similar to the 1973 definition. The most notable difference is the elimination from both subsections of any reference to occurrences, or damage that occurred, during the policy period. These provisions have not been eliminated from the policy, however; instead, they have been moved, and appropriately so, to the insuring agreement, which now reads as follows:

- (a) This insurance applies only to . . . "property damage" which occurs during the policy period. The . . . "property damage" must be caused by an "occurrence."

\* \* \* \*

- (d) "Property damage" that is loss of use of tangible property that is not physically injured shall be deemed to occur at the time of the "occurrence" that caused it.

The drafting history indicates that this change was made, at least in part, to avoid circular language that existed in the 1973 policy. For example, subsection (2) of the 1973 property damage definition addressed loss of use "resulting from an occurrence." The occurrence definition, however, stated that an occurrence "results in . . . property damage." To avoid any potential ambiguity, the Ad Hoc Committee on Special Comprehensive Rules and Forms recommended in 1978 that all references to occurrence be deleted from the property damage definition. Ad Hoc Committee on Special Comprehensive Rules And Forms, Minutes (August 22-24, 1978).

Despite such changes, the basic interpretation of the 1986 definition of property damage is likely to be the same as the 1973 definition.

### D. The Loss of Use Exclusion

Although a discussion of the standard exclusions which may affect loss of use coverage is beyond the

scope of this article, attention should be paid to a particular exclusion in the standard form 1973 policy known as the loss of use exclusion. This exclusion, which also is known as the business risk exclusion, the design defect exclusion and, at times, the performance exclusion, directly tracks the language of subsection (2) of the 1973 definition of property damage. The exclusion bars coverage for:

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,

(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 work by any person or organization other than an insured.

This exclusion applies only to situations where coverage is based on loss of use under subsection (2) of the property damage definition. Its application is restricted to loss of use of non-damaged property due to (1) delayed performance or non-performance of a contract, or (2) unsatisfactory products or work. Drafters of this language offered the following example of how to apply this exclusion:

(1) The insured fuel dealer fails to deliver oil to an apartment building. As a result, the occupants must be evacuated. Neither the loss of rent nor the cost of relocating the tenants would be covered. . . However, if due to the non-delivery of oil, the water pipes freeze and burst, the cost of repair as well as the loss of use would be covered.

\*\*\*

(2) A boiler sold and installed by the insured in a manufacturing plant fails to heat a quantity of water to the specified temperature, and the plant's capacity is thereby reduced. There would be no coverage for the resulting loss. However, if the boiler suddenly and accidentally breaks down, or explodes, without causing physical damage to other property, the loss of use of the plant would be covered.

See Defense Research Institute, *General Liability Insurance - 1973 Revisions* (Vol. 1974, No. 1, Jan. 1974).

In practical terms, the exclusion proved difficult to understand and to apply. Accordingly, it was revised in 1986 to exclude:

"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 the 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.

The impact of these revisions remains to be seen.

#### CONCLUSION

The definition of property damage has created confusion for persons seeking to understand exactly what is covered under standard form policies. This confusion has been at its peak for claims which involve loss of use. The confusion, which has produced incorrect decisions and bad precedent, is largely unnecessary. The answers to most questions about the meaning of the definition of property damage, at least for claims which involve loss of use, is spelled out in the drafting history of the standard form definitions of property damage.