

What Does Your Liability Insurance exclude?

This is the second of a series on liability-insurance issues. Petroleum equipment and insurance expert Brian Donovan focuses on four significant exclusions used in a standard general-liability policy.



Improper installation of nine tanks resulted in expensive removal that would be partially excluded under the CGL policy.

In January's PE&T, I reviewed the various sections of the standard commercial general liability (CGL) policy ("Understanding Your Liability Insurance Policy," Jan. 2000, p. 18). This article focuses on the Exclusions section of the policy. The article addresses four exclusions that should be of interest to petroleum equipment manufacturers, distributors, installers and servicers.

Why exclusions are in

The four exclusions I will discuss are among 14 standard exclusions to the Bodily Injury and Property Damage section of your CGL policy. Each exclusion is worthy of review because each helps define coverage by specifically stating what is not covered. Why are there any exclusions in the policy? From the insurance company's perspective, there are a number of valid reasons:

- Some losses cannot be reasonably insured.
- Intentional acts are within the control of the insured.
- Some losses are covered by other insurance.
- Some exposures are limited to only a few insureds.
- Coverage limitations make the policy more affordable.

Because the CGL policy is generic and insures a broad cross-section of industry, it can ignore the unique exposures of a particular business.

A petroleum equipment company may not be concerned with the liquor-liability exclusion. A restaurant, on the other hand, must seek a specific liquor-liability policy because of its exposure to a significant liability. The aircraft-liability exclusion does not diminish the value of a CGL policy for companies that do not operate aircraft. However, this is a concern for companies that lease planes.

Although most petroleum equipment companies do not have exposure to liquor or aircraft liability, their policies would cost more if these liabilities were not excluded.

What happens if . . .

Before getting into a review of exclusions, the following hypothetical claims will give you an idea of the situations that can arise:

- The product you manufacture does not function as intended after installation. For example, a double-wall tank is installed and found to be defective; the station owner brings a claim for replacing the tank.
- Installation work is defective, and your customer files a lawsuit demanding compensation for the cost of repairing your defective workmanship.
- A defective component in a system or in a piece of machinery results in a business shutdown. The owner demands that the component be replaced. They also demand compensation for the time their station is closed for repair.
- It is discovered that every product installed over a period of time likely has the same defect. The manufacturer incurs costs of more than \$1 million to recall the defective products.

The big four

Considering the brief facts in the above situations, the manufacturers or service companies likely will not be covered for the costs incurred to repair or replace the company's product or work. The coverage denials would be based on one of the following four exclusions:

- Damage to your product (Exclusion k).
- Damage to your work (Exclusion l).
- Damage to impaired property (Exclusion m).
- Recall of products, work or impaired property (Exclusion n).

It is difficult to write about any policy exclusion in absolute terms. Coverage determinations are based on traditional coverage concepts and a vast body of case law in state and federal courts. Court rulings vary from state to state. For example, the "sudden and accidental" pollution exclusion has been upheld in approximately half the states where the issue has been argued.

Sometimes there are unique exceptions that courts find convincing. Also, most court decisions are too voluminous to be summarized in a paragraph or two.

CGL policy has been evolving for years. Insurers wrote what they believed was clear language, only to discover through coverage disputes that the language was ambiguous. Frequently, the CGL policy language was modified or a new version of the policy was issued. Therefore, coverage could be allowed under one version of the CGL policy, but denied in another. Because at least 10 CGL policy-form versions have been in use during the past 25 years, careful review of the specific language in your company's CGL policy is essential.

Because of the variety of policy versions, state court policy interpretations and the unique facts in the cases, using this article as a legal opinion would be inappropriate. Also, do not use it as a definitive

policy interpretation. It merely discusses the concepts behind the four exclusions and the insurers' historical intent in their wording.

Damage to your product

The standard CGL policy excludes "Property damage to your product arising out of it or any part of it." The definition of a product is "goods or products that are manufactured, sold, handled, distributed or disposed of by you."

Say, for example, that a double-wall tank was installed and filled with gasoline. When the service station opened the next day, workers found gasoline in the interstice. The tank did not cause property damage or bodily injury. The damage arose out of the tank itself. The station owner filed suit seeking to recover \$38,000 in tank removal and replacement costs. In this example, the insurer would likely deny coverage because of the "damage-to-your-product" exclusion.

As another example, a supplier of methanol (used to oxygenate gasoline) delivers 5,000 gallons of contaminated methanol that ruins 50,000 gallons of gasoline. The supplier agrees to dispose of the ruined gasoline and replace it. In all probability, the methanol supplier will not be reimbursed by his insurer for the 5,000 gallons of defective methanol. Disposal and replacement of the 55,000 gallons of tainted gasoline probably will be covered.

This exclusion applies even if a separate entity produced a component of the product. For example, the double-wall tank manufacturer purchases a defective piece of pipe used as the monitoring column and incorporates it into the product.

Damage to your work

This exclusion precludes coverage for property damage to the insured's work after it has been completed (completed operations), arising out of the work or any part of it. This exclusion is very similar in concept to the "your product" exclusion.

Example: A contractor installs 600 feet of pipe and fails to properly bond the pipe sections together. The system leaks. Damages include pollution and the replacement of all defective piping. The contractor had a separate pollution policy that covered cleaning the spill. However, the CGL policy did not cover the replacement of the piping because "damage to the work arising out of it or any part of it" is excluded.

This exclusion does not apply if the insured hired a subcontractor to do the work. Only work performed by the insured contractor is precluded from coverage. For example, a petroleum equipment company contracts out the concrete work at a tank-system installation. One year later the concrete is defective and must be replaced. The station owner files suit and the petroleum equipment contractor is liable. Even though the paving was part of the "work" supplied by the contractor, it is not excluded from coverage because the concrete paving is the "work" of the subcontractor and, therefore, covered under the policy.

Damage to impaired property

ABC Electronics supplies a circuit board to Gas Dispensers Inc. that was defective after installation in Gas Dispensers' pumps, rendering the pumps "impaired." Gas Dispensers had to replace the boards and it sued ABC Electronics for the cost.

The dispensers containing the defective circuit boards are "impaired property" according to the CGL policy. The dispensers cannot be used because of the defective boards supplied by ABC Electronics; however, the dispensers can be restored by replacing the boards. The "impaired property" exclusion in ABC's policy precludes coverage for the cost of replacing the circuit boards.

A review of coverage litigation shows that it is unclear whether there is coverage when the removal of defective product from impaired property causes destruction of other property. For example, assume that because of defective lumber, a building has a high probability of becoming unsafe. The defect does not directly damage property, but it renders the building less useful or less valuable, or necessitates destructive alterations of the property to repair the defect. Assume that replacement of the lumber required removing the sheet-rock. In dispute here are the sheet-rock replacement costs and business losses during reconstruction.

Recall of products, work or impaired property

This exclusion precludes coverage for the cost of withdrawal, inspection, repair, replacement or removal of a product or work after discovering a defect in a similar product. For example, a car manufacturer recalls a particular model after a defect results in a crash.

This typically applies to manufacturers and not contractors; however, there are situations where a contractor's "work" may be recalled.

The CGL policy includes this exclusion because the recall cost is not directly related to bodily injury or property damage, but to preventing such occurrences. It is considered a "first-party loss" rather than a "third-party" or liability loss.

A tank manufacturer discovers that the method it used to fabricate compartment tanks resulted in gasoline leaking into the diesel compartment. The manufacturer's costs of inspecting and repairing the 100 similarly-built tanks is excluded.

A piping manufacturer finds that its product is not compatible with alcohol-blend fuels and undertakes the cost of removing all defective piping. The recall-of-products exclusion omits this.

An exception to this exclusion is found in some CGL coverage determinations. If a government agency orders a recall or if a third party initiated the recall and filed suit to recover the recall expenses, some older versions of the CGL policies may provide coverage.

Possible solutions

Each of the exclusions can result in significant uninsured losses. To include coverage, some insurers argue, could make the insurance carrier the business' largest customer. If a piping manufacturer discovers that it's 1999 production was defective, his insurance carrier (if recall is not excluded)

replaces the pipe company's revenues lost as a result of the recall.

Notwithstanding the inherent logic in excluding coverage for your product, your work, your product recall and your impaired property, some carriers recognize these uninsured exposures and are attempting to provide some relief. STICO, for example, provides some warranty coverage and is exploring other policy forms that respond to the four exclusions.

Another possibility is an optional policy endorsement that would provide some coverage. Finally, there are some unique, stand-alone policy forms available that help to respond to the coverage gaps created by the four exclusions.

Obviously, there likely is a cost associated with expanding or supplementing the coverage. One policy form that provides coverage for the four exclusions is priced at approximately 20 percent of the underlying CGL policy. As you might expect, there are exclusions in that form. These include a coverage period time (age) limit for the product or work.

Business owners should familiarize themselves with the Exclusions section of the CGL policy and discuss coverage limitations and policy options with their broker or insurance carrier. m

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