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Recovering Consequential Damages Under General Liability Policies

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An often-overlooked feature of commercial general liability (CGL) policies is that they provide coverage for damages the insured is legally obligated to pay "because of" bodily injury or property damage. Most courts interpret "because of" broadly to include consequential damages and other damages that, while not themselves property damage, are traceable to covered property damage. While consequential damages are less likely to result from bodily injury, the scope of coverage is the same.

The rule that the standard CGL language providing coverage for damages "because of" property damage includes consequential damages having a causal connection to covered property damage is followed by the majority of courts that have considered the question. As one commentator has noted,

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"'Because of' can, and should, be read to mean: as a consequence of, on account of, or arising from. Certainly, this is the ordinary and usual meaning of 'because of.'" Scott C. Turner, Insurance Coverage of Construction Disputes § 6:22 (2d ed.).

In *Am. Home Assur. Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22 (1st Cir. 1986), for example, the court addressed the scope of coverage for damages arising from defective windows installed in the John Hancock office building in Boston. The need to replace the windows resulted in various increased construction and operating costs and delayed the occupancy date from April 1, 1973, to June 1, 1975. Hancock sued the window manufacturer, Libbey-Owens-Ford Company (LOF), and others to recover these damages, which included approximately $11 million for the costs of removing and replacing the windows and an additional approximately $88 million of consequential damages.

The First Circuit held that one reasonable interpretation of the "because of" language is that it "provides coverage not only for property damage, but also for consequential damages resulting from property damage." Id. at 26. The court further noted that, although the policy would expressly exclude coverage for the $11 million in costs associated with the repair and replacement of LOF's own product, the policy did not exclude Hancock's consequential losses resulting from the breakage of LOF's windows. Id. at 27. Accordingly, the court held, "[g]iven that American Home's current policy is at best ambiguous, and at worst clearly applicable to cover LOF's damages, we hold that the policy covers consequential losses stemming from physical injury to LOF's products." Id. at 28.

The First Circuit also cautioned the insurance industry that "an insurance company wishing to exclude consequential damages should use specific language to that effect." Id. at 26. This caution was issued more than 30 years ago, and the "because of" language continues to appear on CGL policies without any specific exclusion for consequential damages.

While the "because of" language is form language found in the vast majority of CGL policies, some states have interpreted the language more broadly than others. In some states, the case law is not necessarily uniform. In California, for example, insurance companies often cite cases narrowly construing the language. But in AIU Ins. Co. v. Superior Court, 51 Cal.3d 807, 814 (1990), the California Supreme Court held that CGL policies cover the costs of reimbursing government agencies and complying with injunctions ordering cleanup under CERCLA, the Superfund statute, and similar statutes. In rejecting the argument that these economic costs were not "because of…property damage," the court held that, "the event precipitating their legal action is contamination of property. The costs that result from such action are therefore incurred 'because of' property damage." Id. at 842. A California Court of Appeals recently followed AIU in holding that certain delay damages were covered, holding that the "delay constitutes a consequential loss (a loss occasioned by the water intrusion) and as such, is part of the damages NAC must pay 'because of' property damage." *Global Modular, Inc. v. Kadena Pac., Inc.*, 15 Cal. App. 5th 127, 145, review den. (Dec. 13, 2017).

Most of the California confusion stems from reliance on pre-1973 cases. In 1973, the definition of "property damage" in standard CGL language issued by the Insurance Services Office (ISO) was revised to specifically include "loss of use of tangible property which has not been physically injured." The prior language had defined property damage as "physical injury to or

destruction of tangible property, including loss of its use." *See Gunderson v. Fire Ins. Exch.*, 37 Cal. App. 4th 1106, 1115 (1995). Several courts had held that under this earlier language, the loss of use referred only to property that was physically injured or destroyed. Id. The 1973 revision makes it clear that the loss of use of property which has not been physically injured also qualifies as property damage.

The California Court of Appeals recently clarified confusion in *Thee Sombrero, Inc. v. Scottsdale Ins. Co.*, 2018 WL 5292072 (Cal. Ct. App. Oct. 25, 2018). The case involved a nightclub called El Sombrero that had its use permit modified after a fatal shooting so that it could be operated only as a banquet hall. The owner sued its security service (CES) alleging that its negligence in allowing the shooting had caused economic damages to the club, including a diminution in the value of the club associated with the modified use permit. After obtaining a default judgment in the amount of the diminished value of the club, the club owner sued CES's liability insurer (Scottsdale) for indemnity. The trial court granted summary judgment for Scottsdale, holding that the club's claims were "for an economic loss, rather than for 'property damage' as defined in and covered under the policy." Id., at *2.

The California Court of Appeals reversed, holding that the club's loss of use as a nightclub constituted property damage and that the resulting diminished value of the club qualified as damages "because of" that property damage. The court went so far as to hold that it "defies common sense to argue otherwise." Id., at *8. The court specifically distinguished the earlier California cases interpreting the older definition of property damage. Id., at *15-16.

Courts also have found coverage for economic losses that arise "because of" bodily injury. In *Cincinnati Ins. Co. v. H. D. Smith, L.L.C.*, 829 F.3d 771, 774 (7th Cir. 2016), for example, the court addressed coverage for an underlying claim brought by the state of West Virginia against drug distributors for costs incurred by the state as a result of its citizens' addiction to drugs supplied by those companies. Id. at 773. The question presented was whether the costs incurred by West Virginia were "because of" bodily injury. Id. at 774-75. The court held they were. Id.

The court based its holding on its recognition that a CGL policy "cover[ing] suits seeking damages 'because of bodily injury'...provides broader coverage than one that covers only damages 'for bodily injury.'" Id. at 774 (original emphasis). The court illustrated the breadth of "because of" in the language at issue by giving the following example:

[A]n individual has automobile insurance; the insured individual caused an accident in which another individual became paralyzed; the paralyzed individual sues the insured driver only for the cost of making his house wheelchair accessible, not for his physical injuries. If the insured driver had a policy that only covered damages "for bodily injury" it would be reasonable to conclude that the damages sought in the example do not fall within the insurer's duty. However, if the insurance contract provides for damages "because of bodily injury" then the insurer would have a duty to defend and indemnify in this situation.

Id. (quoting *Medmarc Cas. Ins. Co. v. Avent Am., Inc.*, 612 F.3d 607, 616 (7th Cir. 2010)).

The types of consequential damages courts have held are covered by the standard "because of" language in CGL

policies are various and extensive.

The Turner treatise, for example, lists the following:

Construction delay and loss of use, liquidated damages for delay, construction impact (i.e., loss of worker efficiency in performing construction work), relocation and storage costs; temporary repairs, diminution in the value of property, later resulting physical injury to other tangible property, the cost to remove and reinstall (or replace) good work in order to access the property damage (often called “rip and tear” damage), the additional repair and reconstruction costs required to bring the building into compliance with the current building code, loss or reduction of production, lost rents, lost profits, increased overhead, environmental response costs under CERCLA and similar statutes, costs incurred for mitigation or prevention of further property damage or bodily injuries, investigation and inspection costs, costs for clean-up and debris removal, costs of notifying adversely affected parties, the insured’s indemnity obligations to others (such as to the insured’s surety on a performance bond), loss of good will or damage to reputation, and emotional distress…

Turner, § 6:22.

The few courts that have upheld denials of coverage for consequential damages have often confused whether the claimed damages constituted property damage, with the operative question of whether the damages were because of property damage. *See, e.g., Kvaerner N. Am. Constr. Inc. v. Certain Underwriters at Lloyd’s London Subscribing to Policy No. 509/DL486507*, 2017 WL 2821691, at *9 (N.D.W. Va. June 28, 2017) (“liquidated damages still must fall under the CGL policy’s property damage definition”); *St. Paul Fire & Marine Ins. Co. v. Amsoil, Inc.*, 51 F. App’x 602, 604 (8th Cir. 2002) (“economic loss which is not ‘property damage’ is not covered under a CGL policy”); *Essex Ins. Co. v. Chem. Formula, LLP*, No. 1:CV-05-0364, 2006 WL 5720284, *6 (M.D. Pa. Apr. 7, 2006) (“loss of profits, damage to commercial reputation, and loss of goodwill are not tangible property damage as defined by the policy”). Insurers often adopt this erroneous position in refusing to cover consequential damages.

The Ninth Circuit recently held that an award of attorneys’ fees to the prevailing plaintiff in an underlying lawsuit against a policyholder is covered under thepolicyholder’s CGL policy. *Ass’n of Apartment Owners of Moorings, Inc. v. Dongbu Ins. Co.*, 731 F. App’x 713 (9th Cir. 2018) (construing Hawaii law). The court held that “in the context of the policy, the plain meaning of ‘damages’ encompasses the fees the Bradens incurred to vindicate their claim for water damage to their home, even if those fees are not a measure of that physical damage.” *Id*. The court also held that the attorney fee award was “because of” the covered property damage, holding “[t]his phrase, which is undefined, connotes a non-exacting causation requirement whereby any award of damages that flows from covered property damage is covered, unless otherwise excluded.” Id. Note, however, that other courts have concluded that an award of attorneys’ fees against the policyholder constitutes “costs” falling within an insurer’s defense obligation, rather than “damages” falling within its indemnity obligation. *See, e.g., Prichard v. Liberty Mutual Ins. Co.,* 84 Cal. App. 4th 890, 911-912 (2000) (attorneys’ fees awarded against the policyholder fall within the scope of a carrier’s supplementary payments obligation because they are statutorily defined in California as costs, and therefore are not “damages” within the meaning of a CGL policy).

One issue that has not been extensively litigated is whether the determination of what damages are “because of” bodily injury or property damage is a question for the court as a matter of law, or one for the court or jury in its role as the fact-finder. The scope of an insurance company’s indemnity obligation (as opposed to its duty to defend, which is broader) often is dependent on the outcome of the underlying case. *See, e.g., United Nat’l Ins. Co. v. Dunbar & Sullivan Dredging Co.*, 953 F.2d 334, 338 (7th Cir. 1992) (“[T]he duty to indemnify must await resolution of the underlying suits.”); *Westfield Ins. Co. v. Sheehan Const. Co.*, 575 F. Supp. 2d 956, 960 (S.D. Ind. 2006) (“The Plaintiff’s duty to indemnify will depend upon the facts and outcome of the underlying Indiana state court action.”) Yet many courts deciding the coverage issue also have decided what damages they deem to be “because of” bodily injury or property damage, rather than leaving that issue for determination in the underlying case.

A recent case from Texas, however, separates the legal question of the meaning of “because of” from the factual question of what damages were “because of” bodily injury or property damage. *See Kenyon Int’l. Emergency Srvs., Inc. v. Starr Indem. & Liab. Co.*, 2018 WL 3431853, at *1 (Tex. App. July 17, 2018). The case involved coverage for emergency services performed by Kenyon for Seaport Airlines after the crash of a Seaport plane, which included setting up a call center, providing first responders and mental health staff, and establishing a welfare support line. Seaport’s aviation policy issued by Starr provided coverage for all sums that the insured shall become legally obligated to pay as damages “because of” bodily injury or property damage. After Seaport went bankrupt and failed to pay Kenyon for the services Kenyon performed after the crash, Kenyon sued Starr seeking a declaratory judgment that Starr’s policy covered the services and recovery in equitable subrogation.

The court first held that, “[v]iewed in the light most favorable to Kenyon, at least some of the damages Kenyon seeks may include sums Seaport became legally obligated to pay because of bodily injury,” and, therefore, covered by the policy. *Id*. at *4. The court then held that “a fact issue [exists] as to whether the reason at least some of the post-crash emergency services were performed – and potentially had to be performed – was bodily injury sustained in the plane crash, or any and all claims related to bodily injury.” Id. The court reversed the trial court’s summary judgment for Starr and remanded for further proceedings, presumably a trial, on the question of which of the damages sought by Kenyon were “because of” bodily injury. *Id.*

Policyholders should consider it a best practice to scrutinize any argument by an insurance company that consequential damages are not covered because they are not bodily injury or property damage. Where those damages arise “because of” covered bodily injury or property damage, they may well be covered.