Commentary

The Risky Business Of The Business Risk

By
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Insured businesses are increasingly looking to their insurers to pay for the insured's failed corporate decisions and flawed business strategies. Courts and aggressive policyholder counsel too often conclude that, unless a liability policy very specifically excludes coverage for the novel business claim, then it must be covered.[1] However, this approach to business risks is fundamentally flawed. There is a well-established and powerful line of precedent that dictates liability policies are not to be twisted and contorted to become the guarantor of a corporation's business schemes or failed commitments.

To examine insurance coverage for a business risk without the guidance of these cases, is like peering into a microscope intending to discover a scientific truth, all the while refusing to apply the correct lens. The foundational public policy considerations against insuring such business risks were forged in the context of construction defect claims, an overview of which is the subject of Sections I and II of this article. This same reasoning has been adopted in the context of professional liability claims, where business risks are also consistently precluded from coverage through analogous, yet differing, contract provisions. This is the subject of Section III below. The common interpretative legal analysis running through these types of claims should also apply to today's most common battle ground for business risks, the advertising injury provision. Section IV below looks at types of business risk claims arising under the guise of advertising injury and the provisions that should apply to preclude an insured from shifting the impact of its business decisions onto its insurers.

I. The Lens: What Is A Business Risk And Why Isn't It Intended To Be Insured?

Of course, certain risks undertaken by a business are intended to be insured. Businesses know that a third party may get sick from eating the insured's food, rear-ended by the insured's delivery truck, or even hurt on the insured's premises by anything from a slip and fall to an unexpected explosion. None of this is what is meant by the "business risk analysis."

A "business risk," the type of which gives rise to the coverage battles addressed in this article, can be broadly identified by one or both of two characteristics:

1) The liability faced by the insured does not arise from injuries the insured accidentally caused to an unsuspecting third party, but instead the liability is to fulfill contractual obligations promised to a third party; and/or

2) The liability faced by the insured is not the result of unexpected injuries caused to a third party, but rather the result of the

insured's business decision to intentionally derive a business benefit at the expense of a third party's business.

Examples of three prototypical "business risks" addressed in this article are: 1) a contractor is liable for fixing a subsiding building he built for a customer; 2) a managed care company miscalculated benefits owed to a class of individuals, having to then pay remaining benefits owed; and 3) the insured uses its competitor's product name as an electronic search term so an internet search for the competitor generates results pointing to the insured's web site. While the insurance analysis of each risk is governed by a series of different terms and conditions, the public policy factors guiding that analysis are the same.

The Minnesota Supreme Court cases of *Bor-Son*[2] and *Knutson*[3] each featured an insured that sought liability coverage for what were essentially the costs of fulfilling alleged contractual obligations. In each case, the Minnesota Supreme Court found that such risks are not covered under the specific insurance provisions in those cases. However, before examining the specific insurance provisions, the Minnesota Supreme Court laid out three fundamental considerations of public policy guiding its analysis:

1) liability insurance covers *damage, injury or harm* to third parties, and not the fulfillment of contractual obligations to third parties[4];

2) a business decision that results in the failure to meet a contractual obligation is a risk better borne by the business who controls the decision, rather than by its insurers; and

3) it is a "moral hazard" to create an incentive for companies to short-change individuals of their contractual due, and allow the companies to pass the risk to liability insurers if caught.

The first principle above recognizes that insurance for injury to third parties is not the same as insurance for failed contractual commitments. If a corporation fails to pay money that is contractually owed to a third party, then when the insured is later ordered to pay that money as a part of a court judgment, the money is neither "damage" nor "injury" nor "harm" within the meaning of a liability insurance policy. Instead, that money is simply the fulfillment of the insured's contractual obligations. The fulfillment of such contractual obligations can be insured through performance or surety bonds,[5] but not through liability insurance.[6]

The second of the three business risk principles indicates that liability insurers do not underwrite and are not expected to insure the soundness of the business model that was within the exclusive control of the insured to investigate, analyze and implement. By way of example, if an insured contracting company conducts a soil analysis and then chooses the wrong sized fill for a house's foundation, this should not be a risk covered by liability insurance. Courts recognize that the consequences of improperly performing such an undertaking are consequences to be borne by the insured to satisfy the promises made to its customers.[7]

The third of the three business risk principles is that courts should interpret liability insurance in a manner to discourage fraud or knowingly substandard performance. In *Knutson*, the Minnesota Supreme Court warned, "even though it cannot be conclusively demonstrated that (finding coverage for contractual obligations) would promote shoddy workmanship and the lack of exercise of due care, undoubtedly it would present the opportunity or incentive for the insured general contractor to be less than optimally diligent in these regards in the performance of his contractual obligations to complete a project in a good workmanlike manner." Of course, as with every good set of rules, there are some exceptions.

The first exception: although the immediate obligations of the insured arising from its contractual failures are not covered, *secondary damages* resulting from those failures may be insured. In other words, if the insured's negligence in installing a heavy steel railing causes the railing to fall, then the cost of replacing the railing is not an insured liability risk, but perhaps the cost of the piano crushed by the railing may be covered. While fulfillment of the insured's contractual commitments are not covered, other damage resulting from the insured's breach may be covered.

The second exception to the business risk principles is that, while the insured's contractual failures are not

covered, the contractual failures of someone doing work on behalf of the insured may be covered. In other words, the insurance industry has recognized that, if the insured subcontracted with another company to complete the contractual obligations, and that subcontractor caused damage, there is a greater likelihood that the insured should be able to access insurance coverage in that instance.

The general principles discussed above each live and breathe within various terms and conditions of the general and professional liability coverages discussed below.

II. Business Risks And Construction Claims Under General Liability Coverage

A. The Construction Business Risk Claims, Including Chinese Drywall

The construction context is where the "business risk" analysis finds its roots. In the coming months, those roots will be put to the test as insurers are expected to face construction claims arising from Chinese drywall litigation.[8] These claims originate from over 500 million pounds of Chinese drywall that was imported to the United States during the post-Hurricane Katrina building boom from 2004 to 2008. Chinese drywall has been found to degrade in humid climates, resulting in the emission of foul-smelling sulfur-like compounds, which allegedly may cause bodily injury and damage to property such as chrome-plated faucets, shower heads, computers, phones and microwaves in the vicinity of the drywall.

While Chinese drywall claims are relatively new, the business risk issues they present are not new. The analysis of these Chinese drywall claims should follow the general approach courts have taken to such business risks in the past. The cost of repairing or replacing Chinese drywall should not be covered if the insured is simply fulfilling its contractual obligations to a third party. Courts will reach this result through any one of a number of avenues. For example:

> Faulty construction materials in need of replacement may not constitute an "occurrence";
>
> Repair to walls that the insured was hired to build or install may be precluded from coverage under the "your product" exclusion;
>
> Replacement of Chinese drywall that has not yet caused third party property damage may be excluded from coverage by the "sistership exclusion"; and
>
> Repair or replacement to walls that were installed not by the insured, but by a subcontractor hired by the insured, may be covered — assuming there is an "occurrence."

Some of the case law supporting these points is discussed below. The analysis within these cases forms the foundation for business risk considerations outside of the construction context as well.

B. Precluding Business Risk Through The GL Insuring Agreement

1. Is Faulty Workmanship An 'Occurrence'?

The insuring provisions of most general liability policies require that the damages at issue must have arisen from an "occurrence" or accident. Therefore, when an insured is hired to perform construction, and that construction is performed in a faulty manner, can it really be said there exists an accidental "occurrence" that allows the insured to obtain insurance coverage to fund the repair or replacement of the construction work? The answer is, "it depends."

Some states have adopted the position that defective work that causes damage to the product itself (e.g. damage to the building) is a business risk that <u>cannot</u> constitute an insurable accident or "occurrence." The seminal decisions supporting this view include *Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 577 (Neb. 2004), *Oak Creek Constr. Co. v. Austin Mut. Ins. Co.*, 998 P.2d 1254, 1257 (Ore. 2000), *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 899 (Pa. 2006), and *L-J, Inv. v. Bituminous Fire & Marine Ins. Co.*, 621 S.E.2d 33, 35-36 (S.C. 2005). In states that follow this approach, the insured's efforts to obtain coverage to fulfill its contractual obligations can be thwarted at the "policy door," i.e. the insuring agreement, because faulty workmanship is not an "occurrence."

However, even in these states where an insured's faulty work is <u>not</u> an "occurrence," courts may still find insurance coverage when that faulty work

causes damage to property *other than the insured's work*.[9] These courts reason that, while the faulty workmanship, sitting by itself in need of repair is not an "occurrence," when that faulty workmanship then causes damage to other property (e.g. the piano), an "accident" or "occurrence" has indeed taken place.

Other courts disagree with the analytical starting point that faulty workmanship cannot possibly constitute an "occurrence." For example, the Supreme Court of Florida in *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*,[10] noted that faulty workmanship can constitute an "occurrence," without regard to whose property is damaged. The court disagreed with the logic of other state courts that indicated, if a faulty wall falls outside the property and damages a parked car, then there is an occurrence, but if the same wall falls inward and needs to be replaced, there is no occurrence. The Florida Supreme Court[11] joined the states of Texas,[12] Minnesota,[13] Kansas,[14] Wisconsin[15] and Tennessee[16] in concluding that faulty work breaching a construction contract can indeed constitute an "occurrence." It is significant to note the flaw in the hypothetical reference in *J.S.U.B.*: if a wall is faulty, then that wall simply needs to be replaced or fixed, and there is no "occurrence." When the wall falls and damages other property, *that fall* is the "occurrence," not the faulty workmanship. Technically, if the wall fell inward and damaged nothing, there may still be an "occurrence," just no claim of third party property damage.

In any event, even in states where faulty work may indeed constitute an occurrence, these jurisdictions still acknowledge that the fulfillment of an insured's contractual commitments are precluded from coverage; although these courts reach the conclusion through the "business risk" exclusions discussed below, rather than relying upon the insuring agreement. In fact, one reason these courts have found that faulty workmanship does constitute an "occurrence" is because otherwise, the business risk exclusions that preclude such coverage would really have no role at all in the policy.[17] As the concurring opinion in *J.S.U.B.* noted:

> The coverage provided . . . must be gleaned in part from reference to the type of policy involved. Here, it should be remembered that a commercial general liability insurance policy is generally designed to provide coverage for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or work is not that for which the damaged person bargained. . . .
>
> Rather, I caution that CGL coverage claims for those things other than the originally intended tort liability to third parties should be viewed with a cautious and suspect eye. . . . In the interpretation of insurance policy language, as with the interpretation of any contract, one should remain cognizant of the type of policy or contract at issue and the type of coverage that is generally and naturally associated with such a policy.[18]

For the purposes of this article, the point is this: some courts find that an insured's failure to adhere to contractual obligations is not covered because it is not an "occurrence" within the insuring agreement. Other courts find that, while failed contractual obligations may constitute an "occurrence," they are nevertheless excluded by the business risk exclusions discussed below. In either line of cases, courts have acknowledged that insureds are not entitled to coverage for their own contractual failings, as is also the case in the professional liability and advertising injury claims discussed in the Sections III and IV below.

2. Is Faulty Workmanship 'Property Damage'?

The insuring agreement in most general liability policies also requires that the "occurrence" at issue must result in "property damage." Therefore, when an insured's product or services are in need of repair, and the insured seeks insurance coverage to fund this business risk, an important inquiry is whether there exists third party "property damage" as defined by the policy.

A prime example of this is seen in *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W.3d 651 (Tex. Ct. App. 2006). The insured, Lennar, built over 400 homes containing defective Exterior Insulation and Finish Systems ("EIFS"), which subsequently caused water damage in many or all of the homes. All of Lennar's insurance carriers denied coverage based on the argu-

ment that the damage to the EIFS did not constitute "property damage" under the insuring agreement.[19] Instead, they argued, these claims were simply seeking to fund the fulfillment of the insured's own business obligations.

The court saw fit to divide Lennar's claims for recovery into three groups:

> (A) the costs to repair water damage to the homes, which constitute 'damages because of . . . property damage'; (B) the costs to remove and replace EIFS as a preventative measure, which do not constitute "damages because of . . . property damage"; and (C) overhead costs, inspection costs, personnel costs, and attorneys' fees, which do not constitute "damages because of . . . property damage.

The court's rationale in its analysis of group (A) was that the defective EIFS did cause water damage to carpet, wood, framing and more in some of the homes, and therefore this damage was "physical injury to tangible property" that fell within the scope of covered "property damage."[20] The court in *Lennar* declined coverage for group (C) for the simple reason that Lennar was not "legally obligated to pay" those costs to a third party, but rather incurred those costs itself.

In addressing group (B), the court found that the replacement of the defective EIFS themselves did not constitute property damage. The court recognized that "physical injury" under the definition of property damage would require property to go from a satisfactory to unsatisfactory state; since the EIFS applied to homes was already in an unsatisfactory state, there could be no physical injury to them, and therefore the defective EIFS could not have caused property damage.[21] Applying similar reasoning to Chinese drywall claims, it may be impossible for the drywall itself to be "physically injured" because the drywall may not have been in a satisfactory state in the first instance. However, one recent Chinese drywall decision, although in the first party context, did find that the "off-gassing" of Chinese drywall rendered the home uninhabitable and constituted physical loss and damage to the walls, thereby satisfying the insuring agreement.[22]

The analysis of the court in *Lennar* adheres to a principle echoed throughout this article: courts may provide coverage when an insured's defective product injures other property, but they are generally reluctant to impose upon insurers the cost of replacing or repairing an insured's shoddy performance. In *Lennar*, the court achieved this goal by finding that products which are defective at the time of installation could not involve "property damage" under the insuring agreement. However, even if a court does find that there has been an "occurrence" that caused "property damage," the types of business risks at issue in this article may still be excluded by one of the business risk exclusions discussed below.

C. Precluding Business Risk Coverage Through The General Liability Exclusions

A discussion of the business risk exclusions begins with the acknowledgement that there is no specific language in a general liability policy delineated as a "business risk exclusion." However, there are at least[23] three exclusions that are often referenced together to effectuate the idea that the fulfillment of contractual obligations is not intended to be insured. These exclusions, sometimes referred to as "the business risk exclusions," are: 1) the "your product" exclusion; 2) the "your work" exclusion; and 3) the recall or sistership exclusion. As one court noted, "the business risk exclusions reflect the proposition that certain business risks are a normal, foreseeable and expected incident of doing business and should be reflected in the price of the product or service rather than as a cost of insurance to be shared by others." *Friel Luxury Home Constr., Inc. v. Probuilders Specialty Ins. Co. RRG,* No. 09-CV-11036-DPW, 2009 WL 5227893, at *6 (D. Mass Dec. 22, 2009).

1. Your Work And Your Product Exclusions

The "your work" exclusion is probably the exclusion that most completely embodies the general principle that an insured is not to receive liability insurance for the fulfillment of its contractual commitments. The 1998 ISO exclusion (l) states that insurance does not apply to:

> "Property damage" to "your work" arising out of it or any part of it and included in the "products-completion operations hazard."

> This exclusion does not apply if the damaged work or the work out of which the damages arises was performed on your behalf by a sub-contractor.

A similar exclusion is the 1998 ISO exclusion (k), the "your product" exclusion, which precludes coverage for "property damage to your product arising out of it or any part of it." If an insured is hired to construct a building (i.e. the insured's "product"), then the "your work" and "your product" exclusions often operate together to prevent the insured from obtaining coverage to fund the fulfillment of faulty workmanship that must be corrected.

One example of the "your work" exclusion is found in the case of *Mid-Continent Cas. Co. v. JHP Dev., Inc.*, 2009 WL 189886 (5th Cir. Jan. 28, 2009). In that matter, a residential condominium developer sued a contractor whose allegedly faulty construction of retention walls allowed water to penetrate the interior of the structure through the ceilings and interior walls. The Fifth Circuit Court of Appeals examined the "your work" exclusion to determine whether it should apply to preclude coverage only for the damage to the retaining walls, or whether it would also preclude coverage for parts of the property that were not actually the subject of the contractor's faulty work.

The Fifth Circuit concluded that the "your work" exclusion should only preclude coverage for the parts of the property that were actually the subject of the defective work (e.g. the retaining walls), and that coverage was <u>not precluded</u> for other consequential damages that resulted from the faulty retaining walls.

As previously mentioned, there is an exception to the "your work" exclusion for instances in which the damages at issue were caused, not by the work of the insured, but by a subcontractor hired by the insured. This exception to the general rule is a middle ground between the position that, on the one hand, the insurance industry does not want to insure the insured's contractual obligations to a third party but, on the other hand, it is common that the insured finds itself holding extra liability for contractual obligations that were actually caused by the performance of another party — the subcontractor.

The sub-contractor exception to the "your work" exclusion was added to the standard general liability policy in 1986 because:

> The insurance and policyholder communities agreed that the CGL policy should provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor rather than the policyholder itself. This resulted both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of insurers that the CGL was a more attractive product that could be better sold if it contained this coverage.[24]

The Florida Supreme Court in *J.S.U.B.* noted that, even if a moral hazard argument could be made to discourage an insured from getting coverage for its own contractual obligations, no such moral hazard applies when providing insurance to cover damages resulting from a subcontractor's work.[25]

2. Recall Or 'Sistership' Exclusion

The *Lennar* decision, discussed above, analyzed the various categories of damages that resulted from a construction defect and concluded that those costs that were related to fulfilling the insured's own contractual obligations were outside the definition of covered "property damage." Another contractual provision that also prohibits coverage for the insured's repair or replacement of its own work is the 1998 ISO exclusion (n). This "recall exclusion" is sometimes referenced as the "sistership exclusion." The name "sistership exclusion" comes from the historical concern that, when airlines detected a problem with one of their planes, they would then ground all "sisterships" to check for the same problem, and then seek to pass the cost of this business decision to its insurers. The sistership exclusion precludes coverage for:

> Damages claimed for any loss, cost or expense incurred by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:
>
> 1) Your product
>
> 2) Your work; or

3) Impaired property

if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.

The sistership exclusion may play a significant role in those business risk claims arising from contractors and developers who begin to replace and repair Chinese drywall, sometimes even before proof of any damages arising from the drywall is established.

As was the case in *Lennar*, often the question of coverage for an insured's repair of its work boils down to where the courts draw a line between damaged property that was encompassed within the insured's work (i.e. probably not covered), and damaged property that was completely unrelated to the insured's work (i.e. probably covered). For example, in *Bright Wood Corp. v. Bankers Standard Ins. Co.*, 665 N.W.2d 544 (Minn. Ct. App. 2003), the insured provided untreated wood to a third party for use in window sashes. After the wood proved defective, the third party decided that, rather than pay the high labor costs of carefully replacing the wooden sashes, it would be more cost effective to replace the entire window to which each wooden sash was attached. The third party then sued the insured for the costs of the window replacement and the insured sought general liability coverage for the claim.

Despite the fact that replaced windows were neither the product or the work of the insured, the court found that the windows and the wooden sashes were so integral to each other that they were considered the same damaged property. *Id.* at 545. Because this property was the subject of the insured's work, the sistership exclusion applied to preclude coverage for the repair and replacement of that work.

In a more recent case with a different twist, a court found that, when an insured's product was such an integral and incorporated part of another product, then the recall of that other product actually was entirely <u>covered</u> because it ceased to be the insured's "work" or "product." In *Amerisure Mut. Ins. Co. v. Hall Steel Co.*, No. 286677, 2009 WL 4724383 (Mich. Ct. App. Dec. 10, 2009), a company named Cleveland Die produced windshield wipers which contained faulty steel that had been manufactured and sold by insured, Hall Steel, which looked to its liability insurance to pay the costs of the wiper recall. The court found that the recall, or "sistership," exclusion did <u>not</u> preclude coverage. The court reasoned that the wipers were not the product or the work of the insured and therefore the sistership exclusion would not apply to preclude coverage. *See id.* at *5.

In both instances above, the court acknowledged the idea that the insured was not to obtain insurance for the repair of the product it was contractually obligated to have provided. However, whether a court is willing or able to differentiate the costs associated with repairing the insured's obligations from other attenuated costs that arose from the breached obligations is a completely different analysis that appears to turn on the very specific facts of each claim.

III. Business Risk In The Managed Care Context Under Professional Liability Policies

A. The Managed Care Business Risk Claims, Including Billing Disputes

What happens when the claim against an insured does not arise from the insured allegedly providing a faulty construction project, but instead arises from the insured's provision of an incomplete or unfulfilled service? Such claims present business risks that arise under professional liability policies instead of under general liability policies. The outcome should nevertheless be the same because, based upon the same business risk principles as those in the construction cases, the insured cannot pass the cost of its contractual obligations to its insurer. As one commentator noted, "professional liability policies are referred to as errors and omissions policies for a reason. They are not designed to ensure that when an insured makes a deliberate business decision to engage in a particular course of conduct — and then is sued for it — any settlement of that suit is fully covered."[26]

In the professional liability context, a recent influx of business risk claims has arisen from underlying managed care litigation that often results in nine-figure settlements. These cases generally center on plan documentation and allegations that the insured

managed care organizations (MCOs) have wrongfully denied or underpaid benefits on a national level. For example, a major multi-district litigation (MDL) took place in Florida in which the plaintiffs alleged that the defendants improperly reduced their contractual payments to doctors by only paying for one service per patient visit despite the doctor having performed multiple procedures. This is called "bundling." The suit also alleged that the MCOs underpaid physicians by paying for a less costly procedure than the one billed by the physician. This is called "downcoding." This MDL, known as *In re Managed Care*,[27] resulted in a settlement against Aetna valued at $470 million, with $170 million in monetary payments. A second settlement followed with Cigna valued at more than $500 million, with an estimated $85 million in cash payments to providers.[28]

In addition to the billing practices disputes that were at issue in the *In re Managed Care* MDL, numerous other cases have alleged that MCOs have failed to fulfill their contractual obligations to plan subscribers or providers. For example, in *Michael Davekos, P.C. v. Liberty Mut. Ins. Co.*, 2008 WL 241613 (Mass. Dist. Ct. Jan 24, 2008), an "out of network" chiropractor sued a health plan for improperly calculating the proper "usual and customary" rate for the provider's services that was to be reimbursed. More recently, allegations have arisen against one of country's largest health insurers accusing it of improperly using a computer algorithm to target and cancel the insurance of individuals diagnosed with breast cancer.[29] Other billing disputes are also arising as today's economy has driven many health providers to more aggressively pursue open balances on bills, bringing the issue of state "balance billing" claims into the forefront of health law litigation trends.[30]

Just as Chinese drywall claims are expected to give rise to business risk insurance claims in the construction context, the above-referenced new crop of challenges to health providers' billing practices is expected to give rise to business risk insurance claims under the companies' professional liability policies. While the terms of those policies differ from general liability policies, there is significant legal precedent indicating that the business risk analysis guiding the analytical approach to general liability coverage also applies to interpreting the terms, conditions and exclusions of professional liability policies.

B. Precluding Business Risk Through A Professional Liability Insuring Agreement

1. Damages, Injury, Harm

Just as a general liability policy is only intended to cover third party "property damage," the insuring agreements of professional liability policies typically also only cover "damages" paid to compensate harm to third parties. The term "damages" is often defined very broadly in such policies, in order to encompass all types of monetary relief that the insured may be required to pay a third party due to the insured's "wrongful act" in providing professional services.[31]

Policyholder counsel have succeeded in convincing some courts that a professional liability insurer's promise to pay "damages" may include coverage for business risks where the insured was ordered by a judge or jury to pay certain amounts to a third party claimant. Policyholders will argue: "we were ordered to pay $1 million in damages, therefore these are precisely the 'damages' insured under our professional liability coverage." This argument can only carry weight if it ignores the fundamental notion that *the term is intended to be applied to money paid to compensate harm or injury brought upon an unsuspecting third party*, and not for contractual obligations owed to a third party. It simply makes no sense to surgically remove the term "damages" from its context in liability coverage, and to conclude that it encompasses any type of money owed by an insured to a third party for any reason.

Fundamental rules of contract construction require that the "damages" definition within professional liability policies must be interpreted in the context of the entirety of the liability insurance policies at issue:

> The intent of the contracting parties is to be ascertained, not by a process of dissection in which words or phrases are isolated from their context, but rather from a process of synthesis in which the words and phrases are given a meaning in accordance with the obvious purpose of the insurance contract as a whole . . . the day is past for adhering to technical or literal meanings of particular words in a deed or other contract against the plain intention of the parties as gathered from the entire instrument.

Cement, Sand & Gravel Co. v. Agric. Ins. Co., 225 Minn. 211, 216, 30 N.W.2d 341, 345 (1947); *see also Plainville v. Travelers Indem. Co.*, 425 A.2d. 131, 136 (Conn. 1979) ("Courts cannot indulge in a forced construction ignoring provisions or so distorting them as to accord a meaning other than that evidently intended by the parties").

Just as it would be absurd to argue that compensation owed by a lunch patron to the restaurant constitutes "damages," so too is it absurd for an insured to trample the guiding principles of the business risk analysis to argue that payments an insured allegedly owed under managed care benefit contracts are "damages" covered by liability insurance.

The First Circuit Court of Appeals addressed whether money owed as a contractual obligation constitutes "damages" in *Pacific Ins. Co., Ltd. v. Eaton Vance Mgmt.*, 369 F.3d 584 (1st Cir. 2004). In that matter, an insured was required to retroactively pay additional benefits under ERISA contracts. The insured sought professional liability insurance for these payments. In rejecting this claim, the court explained that, no matter what legal theories or labels the claimants used in seeking reimbursement from the insured, "any judgment . . . for back-payment of benefits wrongfully withheld . . . necessarily would be derivative of a finding that that Plan documents themselves . . . created the financial obligation on which (the claimants) sought performance." *Id.* at 592. The court concluded that the professional liability policy "does not cover debts that are incurred through a contractual obligation although belatedly paid." *Id.* at 591.

The professional liability analysis in *Eaton* relied upon *Baylor Heating & Air Conditioning, Inc. v. Federated Mut. Ins. Co.*, 987 F.2d 415 (7th Cir. 1993), where an insured sought coverage under a general liability policy for retroactive contractual benefits. The court rejected the insured's claim, finding that the amounts owed were not due to any injury or damage caused by the insured.[32] Instead the amounts paid arose from the "contractual nature" of the insured's obligations. The court in *Baylor* rejected such an attempt to convert a "default arising from a mistaken assumption regarding one's contractual liability" into an insured event.[33]

An insured's attempt to create professional liability coverage for restitutionary payments was also rejected in *Executive Risk Indem. Inc. v. Pacific Educ. Servs., Inc.*, 451 F. Supp. 2d 1147 (D. Haw. 2006). Framing the issue in an insurance context, the District Court of Hawaii examined the difference between contractual restitution and professional liability "damages":

> Restitution . . . often leads to the recovery of a money judgment for an amount paid to the fraudulent party, or for the value of goods or services transferred to him, but such a recovery **cannot properly be described as damages.** Damages are awarded to compensate the injured party for harm caused by the tort, whereas restitution is aimed at depriving the fraudulent party of benefits obtained by the tort.

Id. at 1159 (emphasis added).

Just as money paid by an insured to fulfill contractual obligations should not constitute "damages" in the context of liability coverage, neither should those payments constitute the type of "loss" suffered by an insured that is a prerequisite for coverage under a liability policy, as discussed below.

2. 'Loss' And Causation

The "flip-side" of the requirement that professional liability policies only cover "damages" actually suffered by a third party is that professional liability policies only indemnify actual "loss" that is suffered by the insured. Courts examining the term "loss" in the context of professional liability insurance have held that an insured's payment of benefits owed under a contract does not constitute an actual "loss" or deprivation of an insured's rights. In instances of a business risk, the insured has likely suffered no "loss," but instead simply was forced to pay contractual obligations that it had allegedly contracted to pay in the first place. Another way of approaching this same idea is that the "loss" must be something that was actually *caused* by the "wrongful act" at issue. If the insured's payment to the third party would have been owed regardless of the presence of the wrongful act, then this can be said to fail the "loss causation" requirement of the professional liability insuring agreement.[34]

Cases examining the "loss" requirement have found that the contractual payment of benefits is not "loss"