

# Commentary

# The Risky Business Of The Busin

**By** Adam H. Fleischer

[Editor's Note: Adam Fleischer is a partner at Bates & Carey LLP in Chicago. He specializes in insurance and reinsurance coverage litigation in forum across the country. The views presented herein are those of the author and not necessarily those of the firm Bates & Carey LLP or its clients. Mr. Fleischer wishes to thank Bates & Carey associate Andrew V. Fitzgerald for his invaluable contributions to this article. Responses to this article are welcome. Mr. Fleischer can be contacted at [Afleischer@BatesCarey.com](mailto:Afleischer@BatesCarey.com). Copyright 2010 by Adam Fleischer.]

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.<sup>1</sup> 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

business risk claims, advertising injury provisions have been used to preclude insureds from shifting the impact of their business decisions onto their insurers. This article will focus on the analysis of advertising injury provisions and how they can be used to preclude insureds from shifting the impact of their business decisions onto their insurers.

## **Business Risk**

Business risk claims, as the name implies, involve claims arising from the insured's business operations. These claims may arise from a variety of sources, including product liability, environmental contamination, employment practices, and intellectual property disputes. Business risk claims are often characterized by their complexity and the difficulty of determining the cause of the claim. They may also involve significant legal and factual issues, such as the application of state or federal laws, regulations, and standards of care. The analysis of business risk claims requires a thorough understanding of the relevant laws and regulations, as well as a detailed examination of the specific facts and circumstances of each case. This article will focus on the analysis of advertising injury provisions and how they can be used to preclude insureds from shifting the impact of their business decisions onto their insurers.

## **Advertising Injury**

Advertising injury provisions are designed to protect insureds from claims arising from their advertising activities. These provisions typically provide that the insured will not be liable for damages resulting from the publication of false or misleading statements in its advertisements. They may also provide that the insured will not be liable for damages resulting from the publication of statements that are true but misleading. Advertising injury provisions are often used to preclude insureds from shifting the impact of their business decisions onto their insurers.

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## 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*<sup>2</sup> and *Knutson*<sup>3</sup> 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<sup>4</sup>;
- 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,<sup>5</sup> but not through liability insurance.<sup>6</sup>

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.<sup>7</sup>

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.<sup>8</sup> 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 cannot 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 not an “occurrence,” courts may still find insurance coverage when that faulty work

causes damage to property *other than the insured's work.*<sup>9</sup> 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.*,<sup>10</sup> 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<sup>11</sup> joined the states of Texas,<sup>12</sup> Minnesota,<sup>13</sup> Kansas,<sup>14</sup> Wisconsin<sup>15</sup> and Tennessee<sup>16</sup> in concluding that faulty work breached 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.<sup>17</sup> 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.<sup>18</sup>

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.<sup>19</sup> 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."<sup>20</sup> 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.<sup>21</sup> 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.<sup>22</sup>

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.<sup>23</sup> 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<sup>23</sup> 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 (I) 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 not precluded 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.<sup>24</sup>

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.<sup>25</sup>

## 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 covered 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 not 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."<sup>26</sup>

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*,<sup>27</sup> 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.<sup>28</sup>

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.<sup>29</sup> 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.<sup>30</sup>

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.<sup>31</sup>

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.<sup>32</sup> 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.<sup>33</sup>

An insured’s attempt to create professional liability coverage for restitutionary payments was also re-

jected 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.<sup>34</sup>

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

within the meaning of liability insurance. In *Local 705 Int'l Bd. of Teamsters Health and Welfare Fund v. Five Star Managers*, 316 Ill. App. 3d 391, 735 N.E.2d 679 (Ill. App. 2000), the insured, H&W, was sued for having improperly retained approximately \$20 million in pension fund benefits under the Employee Retirement Income Security Act, 29 U.S.C.A. § 1001 *et seq.* (ERISA). That underlying matter settled for \$16.5 million. H&W sought insurance under a policy that covered "the ultimate net loss which the insured shall become legally obligated to pay." The court found that repayment of wrongfully retained benefits was not "loss":

The term 'loss' is defined as 'the act or fact of losing; failure to keep possession: DEPRIVATION.' . . . Here, there is no question that the sole basis upon which H & W paid out the settlement amount was the Pension Fund's claim that H & W was required to return those monies which it had no right to possess in the first place. Such a payment can hardly be termed a loss. Nor can such a payment create a deprivation any more so than any borrower can be said to suffer a deprivation from being required to repay indebtedness.

*Local 705*, 316 Ill. App. 3d at 396, 735 N.E.2d at 683 (Ill. App. 2000).

The court's decision in *Genzyme Corp. v. Federal Ins. Co.*, 657 F. Supp. 2d 282 (D. Mass. 2009), also establishes that payment of contractually owed benefits is not an insured "loss" under liability coverage. In *Genzyme*, the directors and officers of an insured corporation were sued by shareholders for conspiring to benefit one group of shareholders over another group in the manner that shares were exchanged with the corporation. The suit settled for \$64 million, and the corporation sought insurance from its Directors and Officers liability policy.

The insurer argued that it is contrary to Massachusetts public policy to interpret the word "loss" in the insurance context to cover a corporation's relinquishment of money to which it was not entitled in the first instance. See *id.* at 288-89. The *Genzyme* decision explained that coverage should be precluded for business risks where a portion of contractual pay-

ment obligations were initially withheld but later paid by an insured:

If I pay only \$100 for an item for which I promised to pay \$200, and I am later ordered by a court to pay the additional \$100, I should not be able to claim the additional \$100 as an insurable loss. Had I paid the full \$200 due up front, then clearly no part of the \$200 would constitute loss covered by insurance. The dilatory nature of my obligatory payment should not transform it into an insurable event.

*Id.* at 289.

Just as general liability coverage applies only to third party "property damage" caused by the insured's acts, so too is professional liability coverage only intended to apply to third party harm that was caused by the insured's improper services, and the cost paid to rectify that harm. This idea is sometimes lost in the breadth of professional liability insuring agreements, thereby opening the door for the misinterpretation that monies paid to fulfill business risks may be improperly termed "damages" and "loss." Just as in the general liability context, professional liability policies contain various exclusions intended to prevent such a misapplication of coverage to the insured's business risks.

### C. Precluding Managed Care Business Risks Through Professional Liability Exclusions

The "your work" exclusion described in Section II above precludes coverage for the fulfillment of an insured's contractual obligations, when the insured was generally obligated to provide some sort of tangible building or product to a third party. In the professional liability context, similar exclusions exist to prevent coverage for business risks when the contractual obligations at issue are in the form of providing a service or payment to a third party.

For example, in *Federal Ins. Co. v. Arthur Andersen LLP*, 2005 WL 1838440 (N.D. Ill. Aug. 2, 2005), aff'd in part, rev'd in part, 522 F.3d 740, 743 (7th Cir. 2008), pension plan participants sued the plan administrator (Arthur Andersen) for benefits due under ERISA. The Arthur Andersen policy excluded losses "constitut[ing] benefits due or to become due

under the terms of a Benefit Program." After having settled benefit payments that it allegedly owed, Andersen sought to recharacterize its payment to circumvent the benefits exclusion. Andersen argued that the settlement was not to pay benefits, but rather it reflected insurable "damages" for the loss of benefits caused by the alleged breach of fiduciary duty. The Seventh Circuit Court of Appeals rejected the recharacterization of the settlement:

The fact remains that the settlement reflects the present value of the pension promises (less a haircut reflecting Arthur Andersen's business distress) rather than damages for anyone's misconduct. **No insurer agrees to cover pension benefits; moral hazard would wipe out the market.** As soon as it had purchased a policy, the employer would simply abandon its pension plan and shift the burden to the insurer.

*Arthur Andersen*, 522 F.3d at 743 (applying Illinois law) (emphasis added). "Simply put, Andersen settled claims for benefits. Andersen cannot now create coverage by characterizing its loss otherwise." *Arthur Andersen*, 2005 WL 1838440 at \*15. Therefore, whether in the general liability or professional liability context, courts must recognize that the policies are laden with terms and conditions specifically intended to prevent coverage for the fulfillment of an insured's contractual obligations, and that ignoring this guideline runs the risk of encouraging businesses to play fast and loose with their contractual obligations, knowing all the while that they can pass the cost of repercussions to their insurers.

A benefits exclusion was also enforced in *BOC Group, Inc. v. Federal Ins. Co.*, 2007 WL 2162437 (N.J. Super. App. Div. July 30, 2007). A class action alleged that the insured improperly calculated benefit adjustments, resulting in benefit payments that were "smaller than they should have been." *Id.* at \*5. After settling the dispute for \$69 million, the insured sought liability coverage.

The insurer denied coverage based upon an exclusion for "loss . . . which constitutes benefits due or to become due under the terms of a Benefit Program." Predictably, the insured argued that its settlement

was not for disputed "benefits," but for a disputed enhanced rate of return and for the claimants' attorneys' fees. *See id.* at \*6. The court rejected both arguments and held that the insured was not entitled to coverage. The New Jersey appellate court first noted that it would focus on the substance of the underlying claims rather than the specific legal theories and statutes pled. *See id.* at \*9, \*11. The court relied upon the class settlement agreement, which explained that each claimant's recovery would be based upon the previous benefit amount received, which meant the recovery was also a benefit. *See id.* at \*6, \*11. Both the *Arthur Andersen* and *BOC Group* decisions cited the ruling in *May Dep't Stores v. Federal Ins. Co.*, 305 F.3d 597 (7th Cir. 2002), which presents the common thread weaving together the business risk analysis between general liability and professional liability cases:

It would be passing strange for an insurance company to insure a pension plan (and its sponsor) against an underpayment of benefits, not only because of the enormous and unpredictable liability to which a claim for benefits on behalf of participants in or beneficiaries of a pension plan of a major employer could give rise, but also because of the acute moral hazard problem that such coverage would create. "Moral hazard" is the term used to denote the incentive that insurance can give an insured to increase the risky behavior covered by the insurance. Such insurance would give the plan and its sponsor an incentive to adopt aggressive (just short of willful) interpretations of ERISA designed to minimize the benefits due, safe in the belief that if, as would be likely, the interpretations were rejected by the courts, the insurance company would pick up the tab. Heads I win, tails you lose.

*May Dep't Stores*, 305 F.3d at 601. As discussed in the Introduction, the business risk principles against allowing insurance for a company's contractual obligations do indeed bend somewhat in the situation where the breach of the obligations is caused by a subcontractor, or a party other than the insured. This exception can also be found in the pro-

fessional liability context, and should be recognized as an exception or clarification, and nothing more. For example, in *Benilde-St. Margaret's High School v. St. Paul Mercury Ins. Co.*, 575 N.W.2d 127 (Minn. App. 1998), a school entrusted employee benefit funds to a third party for processing. The third party stole the funds, and the school was entitled to insurance coverage for the repayment of the stolen funds to the IRS, where the funds should have been paid in the first instance. In other words, the insured was indeed entitled to insurance coverage to fund its contractual obligations in this matter, but the breach of those obligations was caused by an entity other than the insured.

#### IV. Business Risks In The Context Of

##### Advertising Injury Coverage

###### A. Business Risk Claims Arising Under Advertising Injury, Including Keyword Advertising

The business risk claims discussed above under the general liability "property damage" analysis are expected to increase significantly in the near future due to the many claims arising from Chinese drywall litigation. The business risk claims discussed above in the professional liability context are expected to increase in the immediate future due to recent attacks on the billing practices of managed care companies. An influx of business risk claims can also be expected in the advertising injury context, with these claims arising from the changing landscape of keyword advertising on the internet and related business risk schemes involving alleged trademark infringement.

A "keyword" is a word, the use of which an internet advertiser may purchase from a search engine, so that when internet users type the word into a search engine, the user will be directed to the advertiser's content. Keyword advertising is a multi-billion dollar industry, in which recent battles have been fought to determine whether the purchase and sale of a trademark for use as a keyword constitutes trademark infringement.<sup>35</sup>

The Second Circuit recently addressed the issue in *Rescuecom v. Google*, 562 F.3d 123 (2d Cir. 2009). Google sold the trademarked term "RESCUECOM" to competitors of the company RESCUECOM, so

that when users would search for that term, the competitors' websites also appear on the results screen. Past cases analyzing such conduct had found that this scenario did not constitute an actionable trademark infringement because the "sponsored links" that appeared on the results screen did not actually use the competitor's trademark "in commerce,"<sup>36</sup> as is required to plead a trademark claim. However, the Second Circuit in the *Rescuecom* case found that, because Google encouraged and actually suggested to customers that they purchase the RESCUECOM trademark as an advertising tool, this was indeed the use of a trademark "in commerce." The case was remanded to be decided on the merits of the trademark infringement allegations.

It remains to be seen whether the majority of courts will deem the use of such trademarks in keyword advertising to constitute actionable trademark infringement claims. However, Google's intentional strategy to sell the trademarks as search terms is a business decision, the risk of which should sit plainly with Google and not with its insurers. With the dominant role the internet plays in modern daily life and commerce, intentional business decisions to capitalize on a competitor's business through keyword advertising and other tactics will continue. The advertising injury provisions that should function to prevent coverage for such intentional business schemes are outlined below.

###### B. Precluding Business Risk Through An Advertising Injury Insuring Agreement

As a broad overview, the advertising injury provision provides coverage against certain types of unfair business claims that arise from the insured allegedly infringing upon the intellectual property of a competitor or making public comments to disparage a competitor's business in some manner. When the actions allegedly taken by the insured contain both an intentional act along with an intended business benefit, as in the RESCUECOM example, the claim has the hallmarks of a business risk, the benefit of which flows only to the insured, and the repercussions of which should be borne only by the insured. In analyzing insurance payments for such business risks, the first argument raised by insurers will be that the trademark claims arising from keyword advertising are not within the advertising injury provision's enumerated offenses.

The 1998 ISO form offers coverage for "those sums that the insured becomes legally obligated to pay as damages because of 'personal and advertising injury'." "Personal and advertising injury" is then defined to include various enumerated offenses that are insured, three of which may particularly lend themselves to the type of business risk disputes addressed in this article. They include:

d. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services.

f. The use of another's advertising idea in your "advertising"; or

g. Infringing upon another's copyright, trade dress or slogan in your "advertisement."

Conspicuously, the three enumerated offenses above make no specific mention of intending to cover trademark claims, but they do make mention of various similar offenses that seem related to the types of allegations anticipated in a keyword advertising dispute. Therefore, there exists an issue as to whether internet advertising disputes involving trademark claims can be covered under the three enumerated offenses listed above.

This dispute over trademark coverage really exists only under pre-2001 ISO forms. Under the 2001 ISO form, trademark claims were specifically excluded through the advertising injury provision's exclusion (i) which states that the insurance does not apply to:

i. Infringement of Copyright, Patent, Trademark or Trade Secret

"Personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights.

However, this exclusion does not apply to infringement, in your "advertisement," of copyright, trade dress or slogan.<sup>37</sup>

Despite this clarification in the 2001 ISO form, claims that arise under earlier versions of the form will continue to raise disputes over whether trademark claims can be covered.

One of the earliest and leading decisions to address this issue was *Advance Watch Co. v. Kemper Nat'l Ins. Co.*, 99 F.3d 795 (6th Cir. 1996). The Sixth Circuit found that the insurance policy's coverage for "misappropriation of an advertising idea" does not include coverage for trademark and trade dress infringement because those torts were not listed, or enumerated, in the provision. While such a ruling would go a long way toward precluding coverage for today's growing list of trademark claims, the *Advance Watch* decision has been rejected by many courts that have since concluded that trademark claims are covered under various enumerated offenses, including "misappropriation of an advertising idea."<sup>38</sup> Nevertheless, even in these jurisdictions, exclusions may apply to prevent insurance coverage in instances where the insured's actions were intentional, where the business benefit was intentional, and where the business detriment to a competitor was intentional.

### C. Precluding Business Risk Through Advertising Injury Exclusions

#### 1. Nonconformity Exclusion

We saw that, in the context of "property damage" claims arising from construction defects, the business risk principles were preserved through the "your work" exclusion, which prevented the insured from obtaining coverage for the fulfillment of its own contractual obligations. In the advertising injury context, the same business risk principles are preserved through the "nonconformity exclusion." This exclusion prevents an insured from passing the burden to its insurer when the insured is sued for failing to provide the advertised product or services. In the 1998 ISO form, exclusion 2(a)(7) states that the insurance does not apply to "personal and advertising injury":

Arising out of the failure of goods, products or services to conform with any statement of quality or performance made in your "advertisement."

A tension arises within the business risk principles when an insured is sued by one of its competitors

for wrongfully inflating and misrepresenting the attributes of the insured's own product. Although liability arising from such misrepresentations about the insured's own products should be excluded by the nonconformity exclusion, the competitors also allege that such advertising tactics cause disparagement to the competitor by implication. In other words "when you tell the world that your product is the only one that works under water, that makes people think my product is less functional or attractive." Disparagement of a competitor's product is a specifically enumerated offense covered under advertising injury. Is it possible for such a claim to fall within both the nonconformity exclusion and the enumerated offense of disparagement?

This issue arose in the recent case of *Total Call Int'l, Inc. v. Peerless Ins. Co.*, 181 Cal. App. 4th 161 (2010). Total Call provided telecommunications products and services including pre-paid phone cards. Two competitors filed a federal court lawsuit against Total Call alleging claims for false and deceptive advertising under the Lanham Act and violation of California's unfair competition law. The competitors alleged that Total Call sold pre-paid phone cards that provided significantly less minutes than the actual minutes advertised by Total Call. The competitors alleged that Total Call's false advertising damaged the reputation of the competitors and the phone card industry as a whole. The competitors further alleged that they lost market share because consumers were misled to ignore the competitors' phone cards and to buy Total Call's falsely advertised phone cards instead.

Although there was no allegation that Total Call had made any specific disparaging comments about the competitors' phone cards, Total Call sought a defense from its general liability insurer under the advertising injury coverage for "[o]ral or written publication, in any manner, or material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services."

The court found that, although the complaint alleged that the competitors suffered "injury by implication" from Total Call's falsehoods, this allegation does not satisfy the requirement of a product disparagement claim because the falsehoods contained no specific reference to the competitors' products. This holding contradicts at least one prior federal court decision

from California in which the court found that a tort claim of "disparagement by implication" may in fact exist when a competitor makes false statements about the superior functioning of its own product.<sup>39</sup>

The *Total Call* decision also noted that, even if a claim for product "disparagement by implication" could be established, such a claim would be excluded from coverage by the policy's "nonconformity exclusion," which eliminated coverage for personal and advertising injury "arising out of the failure of goods, products or services to conform with any statement of quality or performance made in [Total Call's] advertisement." *Id.* at 172.<sup>40</sup> In enforcing the nonconformity exclusion, the California appellate court rejected the argument that this exclusion could only apply to claims brought against the insured by an injured consumer — as opposed to an allegedly injured competitor. *Id.* In making this point, the *Total Call* decision opens the door for insurers to use the nonconformity exclusion to prevent an insured from misrepresenting the attributes of its own product in order to gain a business advantage, and then passing the repercussions of that strategy off to its insurers when it gets caught.

## **2. Knowing Violations And Knowledge Of Falsity Exclusions**

In 1988, the Insurance Services Office (ISO) introduced the "knowing violations" exclusion, which precludes coverage for "personal and advertising injury":

Caused at or by the direction of the insured with the knowledge that the act would violate the rights of another and would inflict personal and advertising injury.

The "knowing violations" exclusion joined another advertising injury exclusion that also intends to prevent an insured from passing the cost of intentional business schemes to its insurer. The second exclusion is the "knowledge of falsity" exclusion, which precludes advertising injury coverage:

Arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity.

These two exclusions, perhaps more than any others, draw the line between coverage for advertising

injury and precluded coverage for a true business risk. When the insured's action is intentional, but the resulting harm to a third party is unexpected, such a claim may be amenable to disparagement, libel, trade dress infringement or other offenses under advertising injury coverage. However, when the insured intends both the act *and the resulting impact on a third party*, this claim is a calculated business risk, no different than a managed care company making a decision to pay individuals less than the individuals feel they are contractually owed.

These exclusions were recently addressed in the case of *AMCO Ins. Co. v. Inspired Techs., Inc.*, No. 08-5748, 2010 WL 597048 (D. Minn. Feb. 19, 2010). The insured manufactured a certain "painter's tape" that was to compete with a similar painter's tape manufactured by 3M. The insured was sued by 3M for allegedly using a "doctored" photo of 3M's product in a marketing brochure and packaging in order to visually misrepresent the effectiveness of the 3M product. These allegations were the basis for 3M's claims of federal unfair competition under the Lanham Act, 15 U.S.C. § 1125(a).

When the insured sought coverage for these claims, a court found that the alleged manipulation of the photo could only have taken place with the intent to deceive. Therefore, the court concluded that the claims were excluded from coverage based upon the policy's exclusion for injury that was caused by the insured knowing that the act would violate the rights of another (the "knowing violations" exclusion), as well as the exclusion for the publication of material at the direction of the insured with "knowledge of its falsity."

In the *Inspired Technologies* decision, the insured had argued that the knowledge of falsity exclusion should only apply in cases of libel, slander and invasion of privacy. The court refused to adopt such a narrow reading of the exclusion, and cited a case where the exclusion was even used to preclude claims for "bait-and-switch" tactics.<sup>41</sup> In acknowledging the application of this exclusion beyond libel, slander and invasion of privacy claims, the court opened the door for the exclusion to be used as yet another tool to prevent insureds from tapping their insurance coverage to pay for the insureds' own intentional business schemes.<sup>42</sup>

## V. Conclusion

Insurers do not benefit from the profits of an insured's intentional business scheme, and insurers should not be forced to fund the repercussions of such business schemes when they go awry. Forcing insured corporations to shoulder the weight of their own business risks plays an important public policy role in discouraging those corporations from engaging in schemes to deprive customers of their contractual due or to gain unfair business advantages from the insured's competitors. Because these business schemes are often hidden, highly technical, and impact millions of dollars, the repercussions of such schemes are best borne by the insured due to its superior knowledge, understanding and control over the risk.

These "business risk principles" will be put to the test in the coming months as new business risk claims find their way to insurers' doorsteps through burgeoning business litigation such as Chinese drywall claims, managed care billing disputes and internet keyword advertising battles. In each context, liability policies provide a series of interrelated terms and conditions that, when read together, prevent insureds from obtaining coverage for such business schemes. By examining the common business risk analyses that run through these seemingly unrelated areas, a pattern emerges, and should continue to emerge, whereby the terms and conditions must be weighed in light of their intent to prevent insured corporations from avoiding the consequences of their own failed business strategies and decisions.

## Endnotes

1. This notion was recently criticized by the Chief Justice of the Minnesota Supreme Court: "It is wrong to assume something that is not excluded is, by that fact, included in coverage. Grants of coverage must flow from the insuring agreement, not from the absence of an exclusion." *General Cas. Co. of Wis. v. Wozniak Travel, Inc.*, 762 N.W.2d 572, 581 (Minn. 2009) (Magnuson, C.J., dissenting).

2. See *Bor-Son Building Corp. v. Employers Comm. Union Ins. Co. of Am.*, 323 N.W.2d 58 (Minn. 1982).

3. See *Knutson Constr. Co. v. St. Paul Fire and Marine Ins. Co.*, 396 N.W.2d 229 (Minn. 1986).
4. See *Knutson*, 323 N.W.2d at 234 (holding that the costs of a breach of contractual obligation by using allegedly faulty materials and methods in constructing a building are tied to the insured's business risk, and are not a risk covered by liability insurance); see also *Burlington Ins. Co. v. Oceanic Design & Constr.*, 383 F.3d 940, 948 (9th Cir. 2004) (stating “[t]he risk of replacing and repairing defective materials or poor workmanship has generally been considered a commercial risk which is not passed on to the liability insurer. Rather liability coverage comes into play when the insured's defective materials or work cause injury to property other than the insured's own work or products”).
5. See *Bor-Son Building Corp. v. Employers Commercial Union Ins. Co. of Am.*, 323 N.W.2d 58 (Minn. 1982) (explaining that a performance bond may cover the insured's cost to make good on its contractual obligations, but liability insurance covers damages or injuries to others resulting from such breaches of contract); see also, *Knutson Constr. Co. v. St. Paul Fire and Marine Ins. Co.*, 396 N.W.2d 229, 234 (Minn. 1986) (holding that the costs of a breach of contractual obligation by using allegedly faulty materials and methods in constructing a building are tied to the insured's business risk, and are not a risk covered by liability insurance).
6. See also, *Home Indem. Co. v. Wil-Freds, Inc.*, 235 Ill. App. 3d 971, 601 N.E.2d 281, 284 (Ill. App. 1992) (stating that “[l]iability insurance should not become a warranty or be converted into a performance bond”).
7. See *Knutson* at 235, n.8 (citing *Weedo v. Stone-E-Brick*, 405 A.2d 788 (N.J. 1979)).
8. For a comprehensive background of Chinese Drywall claims and related issues, see ADAM FLEISCHER, CLIMBING THE GREAT DRYWALL OF CHINA, [http://www.batescarey.com/newsandarticles/Chinese\\_Drywall\\_Presentation.pdf](http://www.batescarey.com/newsandarticles/Chinese_Drywall_Presentation.pdf).
9. For example, in South Carolina, an insured's faulty workmanship does not constitute an occurrence. *L-J, Inv. v. Bituminous Fire & Marine Ins. Co.*, 621 S.E.2d 33, 35-36 (S.C. 2005). However, when faulty workmanship results in water seepage, the cost of repairing the workmanship itself is not an occurrence, but the damage to other property resulting from the seepage does constitute an occurrence. *Katie Hotel Group, LLC v. Amerisure Ins. Co.*, No. Civ.A. 2:04-2212-23, 2006 WL 91577 (D.S.C. Jan. 13, 2006).
10. *979 So. 2d 871* (Fla. 2007).
11. See also, *Auto-Owners Ins. v. Pozzi Window*, 984 So.2d 1241 (Fla. 2008).
12. See *Lamar Homes, Inc. v. Mid-Continent Ca. Co.*, 242 S.W.3d 1 (Tex. 2007).
13. See *Wanzek Constr. Inc. v. Employers Ins. Of Wausau*, 679 N.W.2d 322 (Minn. 2004).
14. See *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486, 491 (Kan. 2006).
15. The decision in *J.S.U.B.* cited the Wisconsin Supreme Court decision in *American Family Mut. Ins. v. American Girl*, 673 N.W.2d 65, 77 (Wis. 2004), for the proposition that faulty workmanship can indeed constitute an occurrence. However, a recent Wisconsin decision cites *American Girl* for the exact opposite proposition, that “a CGL policy does not cover faulty workmanship, only faulty workmanship that causes damage to other property.” *Mantz Auto., Inc. v. Navigators Ins. Co.*, No. 2009AP1681, 2010 WL 1881941 (Wis. App. May 12, 2010).
16. The Tennessee Supreme Court explained in *Moore & Associates* that, if one is to assume that the installation of a shingle or a window is to be completed properly, then whether either item falls or leaks, it is indeed accidental and an “occurrence.” See *Travelers Indem. Co. of Am. v. Moore & Assocs.*, 216 S.W.3d 302, 309 (Tenn. 2007).
17. See *J.S.U.B.*, 979 So. at 892 (Lewis, C.J., concurring).
18. *Id.*
19. *Id.* at 677.
20. See *Id.* at 677-78.

21. See *id.* at 678-79.
22. *Travco Ins. Co. v. Larry Ward*, Case No. 2:10-cv-00014-RGD-TEM (E.D. Va. June 3, 2010).
23. In addition to the three exclusions discussed herein, the “impaired property” exclusion is often referenced as a “business risk” exclusion because it essentially precludes coverage when property has not actually been damaged, but it has simply been rendered less useful by the insured’s delay in performance.
24. JEFFREY W. STEMPFL, STEMPFL ON INSURANCE CONTRACTS, §14.12 [D] at 14-224.8 (3d ed. Supp. 2007).
25. *J.S.U.B.*, 979 So.2d at 36.
26. Karen Reardon and Scott Reed, *Not All Settlement of Claims Are Covered “Losses” Under D&O or E&O Policies*, MEALEY'S: EMERGING INSURANCE DISPUTES, May 20, 2003, Vol. 8, at #10.
27. *In re Managed Case Litigation*, 236 F. Supp. 2d 1336 (S.D. Fla. 2002). The lead case in the MDL was *Shane v. Humana*, Nos. 00-1334-MD-MORENO (“Shane I”), No. 04-21589-CIVMORENO (“Shane II”).
28. See THE TRIAL BARS’ HMO RACKET, <http://www.triallawyersinc.com/healthcare/hc06.html>. See also, SPECIFIC HMO SETTLEMENT INFORMATION, at <http://www.texmed.org/Template.aspx?id=3537>.
29. MURRAY WAAS, WELLPOINT ROUTINELY TARGETS BREAST CANCER PATIENTS, REUTERS (April 22, 2010), <http://www.alertnet.org/thenews/newsdesk/N20207082.htm>. These allegations arise on the heels of Wellpoint paying settlements of over \$20 million in the last two years for two cases in California alleging that the company improperly cancelled policies. See <http://www.californiahealthline.org/articles/2010/4/23/investigation-wellpoint-rescinded-policies-from-breast-cancer-patients.aspx>.
30. Rick Shackelford, Litigation Trends In Managed Care, Address Before HCCA Law Conference (February 24, 2009), available at [http://www.hcca-managedcare-conference.org/past/2009/702-Shackelford\\_handout.pdf](http://www.hcca-managedcare-conference.org/past/2009/702-Shackelford_handout.pdf).
31. One example is found in *St. Paul Fire and Marine Ins. Co. v. Compaq Computer Corp.*, 539 F.3d 809, 818 (8th Cir. 2008), in which “[t]he policy define[d] ‘damages’ as ‘compensatory damages imposed by law,’ ‘consequential damages incurred by the protected person under a contract or agreement,’ and ‘prejudgment interest awarded against the protected person on a judgment in connection with those compensatory or consequential damages.’”
32. *Baylor Heating & Air Conditioning, Inc. v. Federated Mut. Ins. Co.*, 987 F.2d 415, 419-20 (7th Cir. 1993).
33. *Id.*
34. See *Am. Cas. Co. v. Hotel & Restaurant Employees and Bartenders Int'l Union Welfare Fund*, 113 Nev. 764, 942 P.2d 172, 176 (1997) (holding that an insured is not entitled to coverage when the loss at issue simply requires the insured to pay its contractual obligation. “To hold otherwise would allow an insured to turn all of its legal liabilities into insured events by the intentional act of refusing to pay them”).
35. For a more in-depth discussion of the issue summarized herein, see Christina Martini, “Resucecom v. Google, Changing The Future of Keyword Advertising,” DLA Piper Intellectual Property and Technology News, Issue 3, Q3, 2009.
36. See, *1-800-Contacts, Inc. v. WehnU.com, Inc.*, 414 F.3d 400 (2d Cir. 2005).
37. It is also of note that the 2001 ISO from also contained an exclusion for electronic communications on the internet, specifically excluding “Personal and Advertising Injury arising out of the unauthorized use of another’s name or product in your email address, domain name or metatag, or any similar tactics to mislead another’s potential customers.”
38. *Capitol Indem. Corp. v. Elston Self Serv. Wholesale Groceries, Inc.*, 559 F.3d 616 (7th Cir. 2009) (trademark claims fall within coverage for “copyright, title or slogan” as well as “misappropriation of an advertising idea”); *General Cas. Co. of Wis. v. Wozniak Travel, Inc.*, 762 N.W.2d 572 (Minn. 2009)(trademark claims fall within coverage for “use of another’s advertising idea in your advertisement.”); *Premier*

*Pet Prods., LLC v. Travelers Prop. Cas. Co. of Am.*, 678 F. Supp. 2d 409, 418 n.12 (E.D. Va. 2010) (finding that “infringement of copyright, title or slogan” was broad enough to cover trademark infringement claims under Virginia law, rejecting the holding of *Advance Watch Co. v. Kemper Nat'l Ins. Co.*, 99 F.3d 795 (6th Cir. 1996)).

39. *E.Piphany, Inc. v. St. Paul Fire & Marine Ins. Co.*,  
590 F.Supp.2d 1244, 1252-53 (N.D. Cal. 2008).

40. In enforcing the nonconformity exclusion, the court  
relied upon other cases also enforcing the exclusion,  
including *Skylink Technologies, Inc. v. Assurance Co.*

400 F.3d 982, 984 (7th Cir. 2005), *New Hampshire Ins. Co. v. Power-O-Peat, Inc.*, 907 F.2d 58-59 (8th Cir. 1990), and *Superformance Intern. v. Hartford Cas. Ins.*, 203 F. Supp. 2d 587, 589-90 (E.D. Va. 2002).

41. *Callas Enterprises, Inc. v. Travelers Indem. Co. of Am.*,  
193 F.3d 952, 954-56 (8th Cir. 1999).
  42. See also *Custom Hardware Engineering & Consulting, Inc. v. Assurance Co. of Am.*, 295 S.W.3d 557, 563-64 (Mo. App. 2009) (holding that “knowing violations” exclusion precluded coverage for claims of tortious interference with business relations.). ■