Now You See It, Now You Don't: Defective Products, the Question of Incorporation and Liability Insurance

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Comment

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I. INTRODUCTION

Call it an intriguing little multibillion dollar insurance riddle: What constitutes the "property damage" that standard business liability policies cover? Specifically, does merely installing a defective product cause "property damage" to a larger entity?

These questions arise in the context of Comprehensive General Liability ("CGL") insurance, the type of liability insurance used most by U.S. businesses. Central to the standard CGL policy is the insurer's promise to pay on behalf of the insured all damages for which the insured becomes liable because of property damage. This makes the definition of property damage critical for insurers and insureds alike.

Insurance companies periodically modify the standard CGL form, and in 1973 they revised the CGL definition of property damage in a way they insisted would not restrict coverage. Nearly unanimously,

1. The figure is taken from Petition for Rehearing With a Suggestion of Rehearing En Banc of Intervening Defendant Travelers Indemnity Co. of Illinois at 1, Eljer Mfg. Inc. v. Liberty Mut. Ins. Co., 972 F.2d 805 (7th Cir. 1992) (Nos. 91-3203, 91-3251, 91-3298) (arguing that the issue in that case "potentially implicates billions of dollars of coverage nationwide").
4. The importance today of a form released in 1973 may not be immediately apparent. Because CGL policies have traditionally covered any accident or "occurrence" that happens while coverage is in effect, an accident that is discovered years after it occurred can cause an insurer substantial liability under an old policy. See, e.g., Joanne Wojcik, Dow Corning Sues 73 Insurers: Coverage Denial for Breast Implant Claims Spurs Massive Suit, Bus. Ins., July 12, 1993, at 2 (discussing 1993 suit by manufacturer of silicone gel breast implants against insurers that covered its liabilities as far back as 1962).
5. George H. Tinker, Comprehensive General Liability Insurance—Perspective and Overview, 25 Fed'n Ins. Couns. Q. 217, 232-33 (1975). Revisions of standard policies are normally made by insurance company associations such as Insurance Services Office, Inc. ("ISO"). For background information on ISO and the CGL revision process, see infra note 37.
courts disagreed. Both state and federal courts have held that merely installing a defective product is covered as "property damage" under the pre-1973 policies, but not under the post-1973 policies. Recently, though, the Seventh Circuit has taken the position that the post-1973 standard forms do afford coverage.

This Comment first reviews the nature of CGL insurance and its coverage of liabilities arising from property damage. Next it presents and analyzes the orthodox view that incorporation of a defective product does not constitute covered property damage under post-1973 CGL policies. The Comment concludes that courts and commentators espousing this view have misinterpreted key court decisions and have

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6. Even though insurance, as a branch of contract law and specifically under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1988), is generally a matter of state law, federal courts can and do play important roles in interpreting standardized insurance contracts.

Insurance disputes rarely involve questions of federal law. William T. Barker, Insurance Litigation, Diversity Jurisdiction, and the "Direct Action" Proviso, 35 FED'N INS. COUN. Q. 225, 225 (1985). But disputes often end up in federal court because one party or another wants to be there. Id. Diversity jurisdiction under 28 U.S.C. § 1332 (1988) is ordinarily available because insurance companies "are usually deemed citizens only of the states in which they are incorporated and have their principal places of business," and the amounts in controversy often exceed the required $50,000. Id.

Federal courts, in fact, have taken the leading roles in two of the most active areas in contemporary insurance law. On the question of whether CGL policies cover pollution liability that is assessed retroactively under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601-75 (1990) (the "Superfund" law), federal courts have presided over most of the coverage litigation. John O'Leary, Coming Full CERCLA: The Release of Superfund Insurance Coverage Decisions from State Supreme Courts, NAT. RESOURCES & ENV'T, Winter 1992, at 31. Similarly, federal appeals courts have played the leading role in developing theories to determine which liability insurance policies, if any, will cover asbestos injuries and property damage. See generally James G. Gilbert, CGL Interpretation and Delayed Manifestation Disease: Time to Pull the Trigger on Insurer Liability, 38 FED'N INS. & CORP. COUN. Q. 29 (1987) (discussing the four leading "trigger" theories developed by the federal courts of appeal).

State courts acknowledge the federal role in interpreting standardized insurance contracts. Some, in fact, rely heavily on federal precedent. See, e.g., Bank of the West v. Superior Court, 833 P.2d 545, 550 (Cal. 1992). In Bank of the West, the California Supreme Court reversed a finding of CGL coverage for liability under a California unfair business practices statute. Id. at 558. To illustrate the seriousness of the lower court's error, the supreme court cited nine cases ruling to the contrary: six were federal rulings, including two from federal courts sitting outside California. Id. at 550.

Because otherwise clear jurisdictional lines tend to blur when the subject is standard insurance policies, this Comment makes liberal use of both federal and state rulings.

7. See infra notes 43-82 and accompanying text.


9. See infra parts II and III.

10. See infra parts III and IV.
overlooked the most reasonable reading of the 1973 CGL policy.\textsuperscript{11} The Comment proposes that based on the "economic loss" rule of tort law, the post-1973 policies should be construed to cover defective product incorporation as "property damage."\textsuperscript{12}

\section*{II. BACKGROUND}

Liability insurance covers insureds\textsuperscript{13} when they become liable or potentially liable for property damage or bodily injury.\textsuperscript{14} Insurance companies design general liability policies specifically for businesses.\textsuperscript{15} Such policies may cover only one specific risk—e.g., premises liability—or a broad range of specified risks. The broad-range policies are called "comprehensive" policies.\textsuperscript{16}

Liability insurance is rooted in early nineteenth century maritime law.\textsuperscript{17} General liability insurance first gained prominence in the late 1800s.\textsuperscript{18} Initially, insurance companies each drafted their own policies, but by the 1930s confusion and litigation caused by varying policy terms prompted insurance industry trade groups to draft standard

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11. See infra part IV.
12. See infra part V.
13. In effect, liability insurance also covers third parties. Though liability coverage is designed primarily to indemnify the insured for its tort liability to third parties, courts, legislatures, and the public have also viewed liability insurance as a way to assure ultimate compensation for the third parties. ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND COMMERCIAL PRACTICES 376 (1988).
15. The term "general" is used to distinguish the coverage suitable for most businesses from other standard liability forms that specifically cover auto liability, professional liability, or personal liability. HUEBNER, supra note 3, at 369.
16. 1 LONG, supra note 14, § 3.06(1). Comprehensive, though, has a specialized meaning. "Although it is comprehensive in its liability protection, the extensive list of exclusions should put one on notice that it is not 'all risks.'" HUEBNER, supra note 3, at 369. But cf., Carl A. Salisbury, Pollution Liability Insurance Coverage, the Standard-Form Pollution Exclusion, and the Insurance Industry: A Case Study in Collective Amnesia, 21 ENVTL. L. 357, 359 n.6 (1991) ("The comprehensive general liability (CGL) insurance policy was designed to do what its name implies, to insure the policyholder in a comprehensive way against liability to third persons."); Marla Jo Aspinwall, Note, The Applicability of General Liability Insurance to Hazardous Waste Disposal, 57 S. CAL. L. REV. 745, 757 (1984) ("The very title 'Comprehensive General Liability Insurance' suggests the expectation of maximum coverage.")
17. Early in the 1800s, insurers indemnified vessel owners against losses from damages resulting from the collisions of two or more ships. 1 DONALD S. MALECKI ET AL., COMMERCIAL LIABILITY RISK MANAGEMENT AND INSURANCE 57 (1978).
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The first standard policy, an auto policy, was released in 1935.\(^\text{20}\) In 1940, in response to a nudge from state insurance regulators,\(^\text{21}\) two insurance company trade groups released the first comprehensive general liability form.\(^\text{22}\) This constituted a major breakthrough for businesses. For the first time, their general liability policies automatically covered new common law and statutory liabilities.\(^\text{23}\) Another unique feature of the CGL policy was that it covered all liability exposures that were not specifically excluded.\(^\text{24}\) Since 1940, CGL coverage has come to be the most common type of liability policy for businesses.\(^\text{25}\)

19. *Id.* Though some policies, such as certain fire policies, are mandated by statute, this is not true of most standard policies. Instead, it was insurance regulators who encouraged the trade groups to develop standard policies to add a measure of uniformity and to serve as a basis of comparison. Roland J. Wendorff, *The New Standard Comprehensive General Liability Insurance Policy*, 1966 A.B.A. SEC. OF INS., NEGL. & COMPENSATION LAW 250, 251.


21. *Id.* at 220.

22. *Id.*


The advantages of the CGL policy extend beyond coverage for evolving legal liabilities. The policy covers all of an insured's locations and facilities that exist at the time the coverage is bought, and also automatically covers any facilities and locations added later. Previous policies did not cover new facilities or locations unless the policy was altered accordingly. C. ARTHUR WILLIAMS, JR. & RICHARD M. HEINS, *RISK MANAGEMENT AND INSURANCE* 354 (5th ed. 1985).

Protection against new exposures, or unknown hazards as they are called, makes CGL coverage unique and the "most important" form of standard business insurance protection. ROBERT I. MEHR & EMERSON CAMMACK, *PRINCIPLES OF INSURANCE* 289 (1980).

24. WILLIAMS & HEINS, *supra* note 23, at 353. This is not to say that there is any shortage of exclusions in the CGL policy. The policy contains more exclusions than most other coverages, in part because it covers more exposures. MALECKI, *supra* note 17, at 100.

An insurance executive, circa 1941, explained the newer, more expensive coverage as follows:

The burden of determining what to insure and what not to insure is removed from the shoulders of the insured and placed squarely on the producer and the carrier. How much better it is to say—'We cover *everything* except this and this and this' instead of 'We cover *only* this and this and this.'


25. Robert M. Tyler, Jr. & Todd J. Wilcox, *Pollution Exclusion Clauses: Problems in*
Since 1966, general liability policies have come in an "assembly-type" format. A basic unit, called a "jacket," contains the terms, conditions and insuring agreements that are common to all policies. Separate "coverage parts" are added to the jacket to provide any specific coverages a particular insured desires. CGL coverage is one of these coverage parts.

Insurance companies have long tried to implement standard CGL terms and conditions. They have largely succeeded. Standard language promotes price competition and fosters useful legal prece-

Interpretation and Application Under the Comprehensive General Liability Policy, 17 IDAHO L. REV. 497, 498 (1981); 1 LONG, supra note 14, § 3.06(1).

26. For explanations of this format, see William R. Fish, An Overview of the 1973 Comprehensive General Liability Insurance Policy and Products Liability Coverage, 34 J. Mo. B. 257 (1978); Wendorff, supra note 19, at 251-52; Tinker, supra note 5, at 219.

27. The others are: "Owners, Landlords, and Tenants; Manufacturers and Contractors; Completed Operations and Products Liability; Contractual Liability (Designated Contracts); Owners and Contractors Protective Liability (Operations of Designated Contractor); Premises Medical Payments; Storekeepers Liability; Druggists Liability; Comprehensive Personal Liability; and Farm Employers Liability and Farm Employees' Medical Payments." HUEBNER, supra note 3, at 356. The CGL part is considered the best for covering business liability exposures because its coverage is broader than that afforded by the other parts. MEHR & CAMMACK, supra note 23, at 286.

28. "Standard" simply means that the identical language is used regardless of the insurer. "For example, the same standard liability policy written by an insurer of a hotel in Kentucky can be used by another insurer of a hotel in Arizona. In each instance, the 'basic' standard provisions of these two policies...are the same." MALECKI, supra note 17, at 83.

Several prominent insurance company associations recently described the importance of standard forms to the Supreme Court:

Standardized insurance policy forms are critical to the accurate pricing of the insurance product. Without standard definitions of risk, it would be impossible for the industry to pool the data on past losses that is crucial for ratemaking. In enacting the [McCarran-Ferguson] Act, [the 1945 law exempting insurers from key federal antitrust laws] Congress thus regarded industry cooperation on rates and forms as inseparable and essential: "Uniformity as to rates, forms of policies and the like, is not only desirable in insurance, but is necessary." Standardized coverage terms are also at "the core of the 'business of insurance'" because they determine "the type of policy which could be issued, [and] its reliability, interpretation and enforcement." In short, the insurance industry "could not cease to use standard forms without at the same time ceasing to be an insurance business."


29. Fish, supra note 26, at 257.

Even standardized language, however, fails to allow for new legal, commercial, or social developments, so the insurance industry periodically revises its standard forms. The industry revised the CGL form in 1943, 1947, 1955, 1966, 1973, and 1986. Not all these revisions brought about broad or fundamental changes. Definitions and conditions were frequently carried over basically intact from one form to the next. Insurance companies have revised the CGL form for a range of purposes, including: countering adverse court rulings; meeting the demands of insurance buyers; and clarifying ambiguities. Today, revisions are made by an insurance company association, the Insurance Services Office, Inc. ("ISO").

31. Tinker, supra note 5, at 219.
32. Stanzler & Yuen, supra note 23, at 450.
33. For example, the 1966 and 1973 forms are quite similar in their treatment of products liability. Fish, supra note 26, at 257-58.
34. John J. Tarpey, The New Comprehensive Policy: Some of the Changes, 33 INS. COUNS. J. 223, 223 (1966) (“The principle reason given for [the 1966] revision of the [CGL] policies was adverse court decisions.”); Tinker, supra note 5, at 222 n.10 (“A decision of the Louisiana Supreme Court was a prime factor in inducing the 1966 revision[s].”).
35. All standard policies from 1935 to 1966 used the phrase "caused by accident" in the insuring agreement. But customers had been requesting, and often receiving, broader "occurrence"-based coverage for years. ISO broadened the definition of "accident" in the 1966 revision to encompass certain occurrences. Tinker, supra note 5, at 254-57.
36. For example, ISO revised the form in 1973 partly to clarify which insurance policy would cover certain claims that spanned the periods covered by several different policies. Medard M. Narko, The 1972 Comprehensive General Liability Policy: Response to a Continuing Need, 61 ILL. B. J. 34, 35 (1972) (The reference in the title of this article to the "1972" CGL policy indicates the author expected a new policy would be released in 1972 and not in 1973 as it actually was.).
37. In a recent Supreme Court antitrust ruling, Justice Souter provided some background information on ISO:

Defendant Insurance Services Office, Inc. (ISO), an association of approximately 1,400 domestic property and casualty insurers ... is the almost exclusive source of support services in this country for CGL insurance. ISO develops standard policy forms and files or lodges them with each State's insurance regulators; most CGL insurance written in the United States is written on these forms ... For each of its standard policy forms, ISO also supplies actuarial and rating information: it collects, aggregates, interprets, and distributes data on the premiums charged, claims filed and paid, and defense costs expended with respect to each form, and on the basis of this data it predicts future loss trends and calculates advisory premium rates. Most ISO members cannot afford to continue to use a form if ISO withdraws these support services.


Ratemaking by trade associations or bureaus is one insurance company activity that is exempt from the federal antitrust laws under the McCarran-Ferguson Act. See supra note 28. Economic efficiency and public policy are frequently cited as reasons for this exemp-
III. DISCUSSION

A. "Property Damage" Coverage

This Comment focuses on a particular revision to the standard CGL policy, the change in the definition of "property damage" between the 1966 and 1973 CGL forms.

Recall that a liability policy covers the insured business's liability for property damage. So to obtain coverage, an insured must prove property damage. From the original version through the 1955 versions, CGL policies did not define "property damage." Then, in 1966, the industry expanded the definitions section of the policy to state: "Property damage means injury to or destruction of tangible property."

In 1973, ISO revised the property damage definition, splitting it into two parts: one covering damage that includes "physical injury to . . . tangible property," and the other limited to "loss of use" unaccompanied by physical injury. Virtually the same definition appears in the
Thus, all post-1973 standard CGL policies contain the 1973 definition, which limits covered property damage, other than loss of use damage, to that accompanied by "physical injury."

B. Incorporation of a Defective Product as Property Damage Under Pre-1973 Policies

The prevailing view is that under pre-1973 CGL policies, incorporation of a defective product constitutes covered property damage. Two 1950's state supreme court decisions are the leading cases supporting this proposition. Because they are still cited today, these decisions are worth examining in some detail.

In _Hauenstein v. St. Paul Mercury-Indemnity Co._, a distributor sold a new type of plaster to numerous contractors. Once applied, the plaster shrank and cracked, but did not otherwise damage the buildings in which it was installed. The contractors were forced to remove the defective plaster and redo their work. One contractor sued the distributor, which in turn sought indemnity under the CGL policy provision covering liability for property damage.

The insurer denied coverage, contending in part that the plaster had damaged only the distributor's own goods and not the buildings in property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Id. at 10.


43. See infra notes 66-82 and accompanying text.

44. For a discussion of these cases, see infra notes 46-59 and accompanying text.


46. 65 N.W.2d 122 (Minn. 1954).

47. Id. at 124.

48. Id.

49. Id.

50. Id. The court did not specify which form the insurer used. The policy language quoted by the court, defining property damage as "injury to or destruction of property, including the loss of use thereof, caused by accident," is consistent with the 1940, 1943, and 1947 standard forms. See supra note 39.
which it was incorporated, and therefore had not caused "property
damage."

In a passage that has since confounded courts and practitioners, the Minnesota Supreme Court rejected this argument, concluding that because the incorporation of the defective plaster had diminished the value of the building, that incorporation constituted property damage. The *Hauenstein* court, however, did not make clear whether diminished market value was itself property damage, or rather merely a measure of damages. Courts have since resolved this question both ways.

In the second case, *Geddes & Smith Inc. v. Saint Paul-Mercury Indemnity Co.*, aluminum doors began to warp and malfunction shortly after being sold to a contractor who installed them in houses. The contractor sued the door supplier for negligence and breach of warranty, and the supplier in turn sought indemnity under its CGL policy. As in *Hauenstein*, the insurer denied coverage, stressing that

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51. *Hauenstein*, 65 N.W.2d at 124. A separate standard policy provision excluded coverage for "any goods or products manufactured, sold, handled, or distributed by the [i]nsured." *Id.*

52. The *Hauenstein* court stated:

> It is undisputed that after this new type of plaster had been applied it shrunk and cracked to such an extent that it was of no value and had to be removed so that the walls and ceilings could be replastered with a different material. No one can reasonably contend that the application of a useless plaster, which has to be removed before the walls can be properly replastered, does not lower the market value of a building. Although the injury to the walls and ceilings can be rectified by removal of the defective plaster, nevertheless, the presence of the defective plaster on the walls and ceilings reduced the value of the building and constituted property damage. The measure of damages is the diminution in the market value of the building, or the cost of removing the defective plaster and restoring the building to its former condition plus any loss from deprivation of use, whichever is the lesser.

*Id.* at 125.

53. *Compare Wyoming Sawmills Inc. v. Transp. Ins., Co.*, 578 P.2d 1253, 1256 (Or. 1978) (holding that diminution in value is damage) *with* *Hartford Acc. & Indem. Co. v. Olson Bros., Inc.*, 188 N.W.2d 699, 705 (Neb. 1971) (holding that it was the incorporation itself that constituted the damage and stating that "[*Hauenstein*] is one of a number of similar cases in which a supplier's product was incorporated into a structure and because it was defective there was damage to the work into which the product was incorporated"). The *Wyoming Sawmills* court stated:

> [*Hauenstein and its progeny*] hold that despite the lack of physical damage to the larger entity into which the defective product has been integrated, the value of the larger entity has been depreciated by the defective product which has been integrated into it, and that such depreciation in value constitutes 'property damage.'

*Wyoming Sawmills*, 578 P.2d at 1256 (emphasis added).

54. 334 P.2d 881 (Cal. 1959).

55. *Id.* at 882.

56. The policy in *Geddes & Smith*, like that in *Hauenstein*, covered damages imposed
the only damage was to the insured's own goods. Rejecting this argument, Justice Traynor relied upon *Hauenstein* to support the proposition that the houses themselves were damaged by the incorporation of the defective doors.

After insurance companies added the definition of "property damage" to the CGL form in 1966, courts quickly applied *Hauenstein* and *Geddes & Smith* to conclude that under that definition, incorporation of a defective product constituted "property damage." By 1973, this construction was so dominant that the Ninth Circuit termed the incorporation issue "well-settled." But the issue proved less settled than the Ninth Circuit maintained.

C. Turning the Tables: No Coverage of Incorporation Under Post-1973 Policies

In 1973, ISO issued a new CGL form to replace the 1966 form. For the most part, the 1966 and 1973 CGL forms were quite similar,

"because of injury to or destruction of property, including the loss of use thereof, caused by accident." *Id.* at 882-83.

58. *Id.* at 885.

60. This position was dominant but not unanimous. *See, e.g.*, Hamilton Die Cast, Inc. v. United States Fid. & Guar. Co., 508 F.2d 417, 418-19 (7th Cir. 1975) (holding that although defective frames forced sporting goods firm to refund money for its tennis rackets there was no "property damage" under 1966 form definition); Dreis & Krump Mfg. Co. v. Phoenix Ins. Co., 548 F.2d 681, 686 (7th Cir. 1977) (following *Hamilton Die Cast*).

61. Specifically, the court stated:

Under well-settled principles, when one product is integrated into a larger entity and the product proves defective, the damage is considered as damage to the entity to the extent that the market value of the entity is reduced by an amount in excess of the value of the defective product.

*Goodyear*, 471 F.2d at 1344.
differences being largely limited to the definitions sections. Still, even those ostensibly minor changes generated concern among more cynical insureds. The insurers maintained, however, that the new property damage definition in the 1973 form only clarified their intended scope of property damage coverage, rather than restricting coverage. Yet courts quickly and nearly unanimously disagreed.

62. Fish, supra note 26, at 257-58. Both "bodily injury" and "property damage" were redefined in the 1973 policy. Bodily harm was defined in the 1966 policy as "bodily injury, sickness or disease sustained by any person." DRI, supra note 40, at 7. The 1973 form defined bodily harm as "bodily injury, sickness or disease sustained by any person which occurs during the policy period, including death at any time resulting therefrom." Id. at 8.

For discussion of the 1973 form's changed "property damage" definition, see supra notes 40-42 and accompanying text.

63. See, e.g., Leslie Murray, Risk Men Express Need for Caution on New CGL Changes, BUS. INS., Jan. 1, 1973, at 1. Commenting on the 1973 CGL changes, an Illinois official who bought insurance for the state said: "The changes in the 1966 policy were publicized 'purely editorial,' but that wasn't necessarily true. You can always be sure the carriers have something in the back of their grubby little minds." Id.

64. The question of what scope of coverage the parties intended is a principal focus in insurance coverage litigation. As Judge Coffin explained:

Insurance policies are generally interpreted the same way as other contracts. In construing the policies at issue, our dominant purpose is to give effect to the intention of the parties. Where the relevant language is unambiguous and the application of the policy to the relevant facts is clear, that intent must be ascertained by the plain and ordinary meaning of the contract language. Where, however, the policy terms are ambiguous and the coverage issue is reasonably disputed, a court may consider extrinsic evidence of the surrounding circumstances and of the parties' intent. For example, evidence of the construction given to the language by the parties and of the customary usage of persons in the same commercial setting is normally admissible. If the meaning of the policy terms remains unclear, the policy is generally construed in favor of the insured in order to promote the policy's objective of providing coverage.

Eagle-Picher Industries Inc. v. Liberty Mut. Ins. Co., 682 F.2d 12, 17 (1st Cir. 1982) (citation omitted).

Intent of the parties has been referred to as the "polar star" of insurance contract interpretation. APPLEMAN, supra note 18, § 7385 at 110.

The intent and meaning of the parties is far more important than the strict and literal sense of the words used in the contract. For that reason it is equally important to consider the subject matter of insurance and the purpose or object which the parties had in view at the time . . . .

Id. at 126-27.

To the extent that it can be ascertained, the intent of those who drafted the policy is often considered probative of the intent of the parties. See infra note 65.

65. As one contemporary commentator, himself an insurance company lawyer, explained:

This 1973 version is designed to clarify the intent that "property damage" includes the loss of use of tangible property which itself has not been physically injured or destroyed. The 1966 edition defined "property damage" as meaning "injury to or destruction of tangible property." And the word "dam-
In *Wyoming Sawmills, Inc. v. Transportation Insurance Co.*, the first major ruling on the 1973 definition, the Oregon Supreme Court held that incorporation of defective two-by-four studs into a new building was not "property damage." The studs had warped and had to be replaced, but they had not otherwise damaged any part of the building. The insured relied on *Hauenstein* and its progeny for the proposition that incorporation of a defective product constitutes property damage to the larger entity. Relying exclusively on the new definition, the court rejected that argument, stressing that the term "physical," which appeared in the 1973 but not the 1966 form, excluded coverage for diminution in value.

In the next major decision interpreting the new definition of "property damage," the Minnesota Supreme Court revisited the *Hauenstein* decisions. The 1973 definition of property damage clarifies this area of confusion both as respects injury, which is now qualified by the word "physical" to include non-physical or intangible injury, such as loss of use, so that the definition of property damage would itself include the loss of use of the building in the illustration without any help from the "damages" definition. While that construction might provide a short-cut to intended coverage [in a particular example] it does violence to rules of construction and would do violence to intent of coverage in other types of cases. If this construction were followed, that portion of the "damages" definition which relates to the loss of use of property would be meaningless, whereas the rule of construction presumes that all of the terms of the contract have meaning and are included for a purpose.

The filing memorandum written by the Insurance Services Office to the various state insurance departments notes that this change in definition is designed to be a clarification of intent, and not a change in intent.


66. 578 P.2d 1253 (Or. 1978).
67. *Id.* at 1256.
68. *Id.* at 1255-56.
69. *Id.* at 1256.
70. The *Wyoming Sawmills* court commented that "[t]he inclusion of ['physical'] negates any possibility that the policy was intended to include 'consequential or intangible damage,' such as depreciation in value, within the term 'property damage.' The intention to exclude such coverage can be the only reason for the addition of the word." *Id.* (footnote omitted).
question in *Federated Mutual Insurance Co. v. Concrete Units, Inc.*

In *Concrete Units*, concrete used in constructing a grain elevator hardened improperly and had to be removed. Both the owner of the elevator and a contractor on the project sued the concrete supplier, which then sought indemnity under a CGL policy containing the 1973 definition. As had the *Wyoming Sawmills* court, the *Concrete Units* court held that incorporation of a defective product did not constitute property damage under the new definition.

Of the many other courts that have followed suit, perhaps none did so as affirmatively as the Tenth Circuit in *Hartford Accident & Indemnity Co. v. Pacific Mutual Life Insurance Co.* In *Hartford*, a bankrupt contractor had installed a faulty glass wall curtain system in a new building. After window units began to break and their reflective coating began to deteriorate, the contractor sought coverage under two general liability policies: a primary policy which used the 1966 definition of property damage, and an excess policy which used the 1973 definition. The court found "property damage" coverage under the 1966 definition, but no such coverage under the 1973 definition.

Currently, then, the weight of authority holds that incorporation of a

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71. 363 N.W.2d 751 (Minn. 1985).
72. Id. at 753.
73. Id. at 754. Among the damages sought were repair expenses, lost profits from other work the contractor could have been doing had there been no delays, and loss of use of the storage space. Id.
74. Id. at 755.
75. *Concrete Units*, 363 N.W.2d at 756. The concrete supplier's "loss of use" claims were covered. Id. at 756-57.
76. See, e.g., New Hampshire Ins. Co. v. Vieira, 930 F.2d 696, 700 (9th Cir. 1991) (holding that incorrect installation of drywall that later had to be repaired and strengthened is not property damage under the 1973 definition); Millers Mut. Fire Ins. v. Ed Bailey Inc., 647 P.2d 1249, 1251-53 (Idaho 1982) (holding that installation of polyurethane foam that contributed to fire in storage facility is not property damage under 1973 definition).
77. 861 F.2d 250 (10th Cir. 1988).
78. Id. at 252.
79. Excess policies provide coverage above the limits of other, primary policies. MEHR & CAMMACK, supra note 23, at 295. For example, corporation X may have a primary liability policy from one insurance company that covers liability for damages up to $50 million. An excess insurer might sell corporation X an excess policy covering, for example, liability over $50 million and up to $100 million.
80. *Hartford Acc. & Indemnity Co.*, 861 F.2d at 252-54.
81. The court noted: [T]he 1966 version of 'property damage' has been construed to include diminution in value as well as physical injury and loss of use. . . . [The 1973 revision] was intended to preclude coverage for intangible injuries such as diminution in value.

Id. at 254.
defective product is not property damage under the 1973 definition. As evidenced by a recent decision of the Seventh Circuit, however, this may be changing.

D. The Eljer View of the Post-1973 Policies

The United States Court of Appeals for the Seventh Circuit, in Eljer Manufacturing, Inc. v. Liberty Mutual Insurance Co., recently contradicted the prevailing view by drawing upon tort law, economic theory, and CGL drafting history to conclude that incorporation of a defective product is itself covered "property damage" under the 1973 definition. In Eljer, the manufacturer of leak-prone pipes sought

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82. Cases involving the presence of one highly toxic product—asbestos—in buildings form a narrow exception to this general rule. For reasons explained below, these "asbestos-in-building" cases are distinguishable from other defective product incorporation cases and are not considered extensively herein.

Among the most common asbestos-containing materials installed in buildings are sound-proofing and insulation. Mark E. Wojcik, Tracing the Fibers of Asbestos Litigation: When Do an Insurer's Duties of Defense and Indemnity Arise? 36 Fed'n. Ins. COUN. Q. 283, 285 (Spring 1986). When such materials are "friable"—that is, when dry they can be crumbled, pulverized or reduced to powder by hand pressure—they release asbestos fibers in the air. Id. at 288. Any exposure to these fibers is unsafe. Id. at 286. Therefore, the very presence of asbestos fibers (unlike leaky pipes or cracking plaster) constitutes a "physical injury" compensable under tort law. See Adams Arapahoe School Dist. No. 28-J v. GAF Corp., 959 F.2d 868, 872 (10th Cir. 1989); City of Greenville v. W.R. Grace & Co., 827 F.2d 975, 977-78 (4th Cir. 1987); United States Fid. & Guar. Co. v. Wilkin Insulation Co., 578 N.E.2d 926, 931 (Ill. 1991).

Even the terminology used in these cases is instructive. Rather than speaking of "incorporation" of asbestos into a building, courts refer to the "contamination" of the building by asbestos. Adams-Arapahoe, 959 F.2d at 872; City of Greenville, 827 F.2d at 978; Wilkin, 578 N.E.2d at 931. Because contamination damages the buildings, asbestos installation is a physical injury.

Outside the context of asbestos, at least five cases, some already cited herein, support the proposition that diminution in value claims are not covered under the 1973 definition. These cases are collected in Barry R. Ostrager & Thomas R. Newman, Handbook on Insurance Coverage Disputes 226 (1992). Ostrager and Newman cite only Missouri Terrazzo Co. v. Iowa Nat'l Mut. Ins. Co., 740 F.2d 647, 650 (8th Cir. 1984) for the alternative proposition.

83. 972 F.2d 805 (7th Cir. 1992), cert. denied, 113 S. Ct. 1646 (1993).


Admittedly, there is one far more pedestrian factor that may have played a role in Eljer: The stakes were simply much higher than in many of the previous cases involving incorporation of defective products. The manufacturer projected a tort liability of several hundred million dollars, most of which it hoped to recover from insurance proceeds. Eljer, 972 F.2d at 807. By contrast, Young v. Insurance Co. of North America, 870 F.2d 610, 610 (11th Cir. 1989), involved a claim for $350,000; New Hampshire Ins. Co. v.
coverage for homeowners' suits under several excess and primary liability policies, all of which used the 1973 definition of property damage. Some of the homeowners had suffered leaks; others had not, but claimed the value of their property had been diminished by the presence of the potentially defective system. In cases in which the pipes had leaked during the policy period, the insurers did not contest coverage. But predictably, for cases in which the pipes did not actually leak during the policy period, the insurers denied coverage on the basis of lack of the "physical injury" required by the 1973 definition of property damage.

Writing for the court, Judge Posner characterized the case as an argument over two competing definitions of the term "physical injury." He posited that insurers favor a definition that emphasizes "physical," which connotes injury that causes a physical alteration to the thing injured. He observed that insureds, on the other hand, would like a definition that gives greater prominence to "injury," which connotes loss that results from some physical contact. Finding it more compatible with the aims of the CGL drafters and the nature of insurance

Vieira, 930 F.2d 696, 697 (9th Cir. 1991), involved a claim for $300,000; and Wyoming Sawmills v. Transp. Ins. Co., 578 P.2d 1253, 1255 (Or. 1978), involved a claim for roughly $17,000. Federated Mut. Ins. Co. v. Concrete Units Inc., 363 N.W.2d 751 (Minn. 1985) does not indicate how much was at stake. For an interesting account of how closely the financial world monitors the legal one, see Robert Hurtado, Market Place: Eyes Are on Eljer As It Wins Ruling, N.Y. TIMES, Sept. 15, 1992, at D8.

85. An estimated 5 percent of these particular plumbing systems failed. Eljer, 972 F.2d at 807. For criticism of the Eljer court for not setting specific standards on failure rates for courts to use in discerning which products are defective, see Michael J. Sehr et al., Insurance Coverage Litigation: Recent Developments, 28 TORT & INS. L.J. 333, 345-46 (1993).

86. Eljer, 972 F.2d at 807.
87. Id.
88. The policy period is the time during which the policy is in effect. Most standard policies require only that the onset of damages occur during this time. MEHR & CAMMACK, supra note 23, at 161-62.
89. Eljer, 972 F.2d at 807.
90. Id. For that proposition, the insurers cited many of the federal appeals court rulings previously mentioned as well as cases construing New York and Illinois law, each of which governed some of the policies involved in Eljer. Brief and Appendix for Intervening Defendant-Appellee/Cross-Appellant Travelers Indemnity Co. of Illinois at 8-16, Eljer Mfg. Inc. v. Liberty Mut. Ins. Co., 972 F.2d 805 (7th Cir. 1992) (Nos. 91-3203, 91-3251,91-3298).
91. Eljer, 972 F.2d at 810.
92. Id.
93. Id.
94. See id. at 810-11. Neither the insurers, nor the plaintiff manufacturer, nor Judge Posner provided first-hand drafting history evidence of the drafters' intent. The insurers asserted that the manufacturer had waived any drafting history arguments by not raising
coverage, the court opted for the insureds' preferred definition. Thus the Eljer court held that under the 1973 definition, incorporation can itself be property damage if there is physical contact.

IV. ANALYSIS

A. Why Did ISO Make the 1973 Change?

Certainly, the intent of ISO, the policy drafters, has some bearing on the meaning of the 1973 property damage definition. But rarely is it entirely clear why insurers change policy language. Nonetheless,

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many courts claim to know precisely why ISO altered the property damage definition in 1973.\textsuperscript{100} Commentators seem a bit less unanimous,\textsuperscript{101} but the consensus is that the new definition was intended to eliminate coverage for liability arising from incorporation of defective products.

Yet, generally, ISO sought to "clarify," not restrict, the then-existing scope of coverage for property damage.\textsuperscript{102} More specifically, one court that examined the background of the 1973 CGL policy at length concluded that its drafters expressed no intent to eliminate coverage for damage from incorporation of defective products.\textsuperscript{103} Some commentators agree.\textsuperscript{104} Thus, there is some question regarding whether ISO in-

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Documents revealing industry intent are not always easy to come by. See, e.g., Hoechst Celanese Corp. v. National Union Fire Ins. Co., 623 A.2d 1099 (Del. Super. Ct. 1991). In Hoechst, the insured requested discovery of CGL drafting history and other documents. Id. at 1106. The insurer argued that such documents were extraneous because the policy was unambiguous, and raised objections including vagueness, overbreadth, burden, attorney-client privilege, work-product doctrine, and the protection given to proprietary business data. Id. Ultimately, though, the court granted the discovery request. Id. at 1117.

100. See, e.g., American Home Assur. Co. v. Libbey-Owens-Ford Co., 786 F.2d 22, 25 (1st Cir. 1986) (stating that "[t]he critical difference in policy language is the result of a 1973 revision of the Comprehensive General Liability Policy, used by most insurance companies, which expressly added the modifier 'physical' injury to the definition of 'property damage' in order to restrict recovery for intangible losses"); Wyoming Sawmills, Inc. v. Transportation Ins. Co., 578 P.2d 1253, 1256 (Or. 1978) ("The inclusion of [physical] negates any possibility that the policy was intended to include . . . depreciation in value, within the term 'property damage.' The intention to exclude such coverage can be the only reason for the addition of the word.").

101. For an interpretation that the 1966 definition permitted diminution in value claims but the "narrower" 1973 definition did not, see Laurie Vasichek, Note, Liability Coverage for "Damages Because of Property Damage" Under the Comprehensive General Liability Policy, 68 MINN. L. REV. 795, 809-12 (1984).

For an interpretation more favorable to insurance companies, namely that insurers meant to exclude coverage for consequential and intangible damages under the 1966 policy, but court rulings caused confusion which insurers tried to eliminate with the 1973 definition, see Narko, supra note 36, at 35.

102. See Tinker, supra note 5, at 232-33; Narko, supra note 36, at 34.

103. See Reply Brief and Response to Cross-Appeals for Plaintiff-Appellant/Cross-Appellee Eljer Manufacturing Co. at 10, Eljer Mfg. Inc. v. Liberty Mut. Ins. Co., 972 F.2d 805 (7th Cir. 1992) (Nos. 91-3203, 91-3251, 91-3298) (citing Asbestos Insurance Coverage Cases, Phase V-A, No. 1072 n.12 at 2 (Cal. Sup. Ct. Jan. 24, 1990), as positing that the drafting history of the CGL "indicates that the physical injury requirement was added to eliminate coverage for intangible losses. The drafters were not seeking to restrict coverage for defective product claims.").

104. See, e.g., Kirk A. Pasich, Insurance Coverage for Asbestos Building Cases:
tended the 1973 definition to eliminate incorporation damage coverage.

Perhaps the answer lies not in what insurers did or declared, but in what they have not done. Although they have had ample opportunity to protest and change the coverage of incorporation damage, they have not done so.

Recall that until the 1973 form, nothing in the CGL definition of property damage conditioned coverage on physical injury. That nonrestrictive language led to excessive coverage obligations. In response, some insurers attempted to establish that even under pre-1973 policies, property damage coverage was limited to physical damage to tangible property. Yet during the same time, the insurance industry said little about coverage for incorporation of defective products. In fact, by 1973 courts had been ruling that incorporation constituted property damage for nearly two decades, but the insurers did not affirmatively exclude coverage for such damage in the 1973 form. Insurers, of course, know how to exclude coverage: Exclusions are

There's More Than Property Damage, 24 TORT & INS. L. J. 630, 640 (1989) ("In addition, the drafting history of the 1973 CGL policy, which expressly treats loss of use as property damage, shows that the drafters intended to clarify, not change, the coverage provided." (citation omitted)).


106. See, e.g., St. Paul Fire & Marine Ins. Co. v. Northern Grain Co., 365 F.2d 361, 366 (8th Cir. 1966) (holding that wheat crop was injured by sale to farmer of a type of seed that was less productive than the type actually sought); Wells Labberton v. General Casualty Co. of Am., 332 P.2d 250, 255 (Wash. 1958) (holding that production lost when a defective sprayer missed part of the field is "injury" to property).

107. See Wendorff, supra note 19, at 254.


109. The 1973 CGL policy contains no fewer than 17 exclusions. DRI, supra note 40, at 13. CGL coverage is excluded, for instance, when an insured's "mobile equipment" (defined to include race cars, go-carts, snowmobiles) is used for racing or stunts. Id. at 14. Coverage is also excluded when a named insured, by its delay or lack of performance on a contract or the failure of its own products, causes loss of use of certain tangible property. Id. at 16.

Among the least factious of the exclusions is Exclusion (g), the war exclusion, which says the CGL does not apply:

[T]o bodily injury or property damage due to war, whether or not declared, civil
an integral part of CGL coverage, because the policies presume coverage unless a risk is specifically excluded.\textsuperscript{110}

If not through a new policy exclusion, how could the coverage for incorporation of defective products that existed under the 1966 language have been eliminated? As explained above, this change came from the courts, which since the late 1970s have held that by qualifying "injury" with "physical," the 1973 policy limited property damage coverage to injuries that are predominantly physical.\textsuperscript{111} Curiously, though, this construction seems to have escaped insurance law commentators, who, shortly after the release of the 1973 policy, attempted to predict its impact.\textsuperscript{112} Moreover, some commentators and at least one court have found this construction unconvincing.\textsuperscript{113} Thus the law governing coverage of incorporation damage under the post-1973 policies has been shaped by the courts alone, and in contradiction to the ostensible intent of the industry that created the policies.

B. What Did Hauenstein Really Say?

Confusion over the incorporation issue can be also traced in part to misinterpretation of the Hauenstein case, which still seems to influence much thinking and writing. The problem stems from the Hauenstein court's implication that diminution of the market value of a larger entity

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Tinker, supra note 5, at 302 (emphasis deleted from original).

Probably the most debated CGL exclusion is Exclusion (f), the environmental pollution exclusion, added to the standard form in 1973, which excludes CGL coverage for:

(B)odily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water . . . .

DRI, supra note 40, at 25. This exclusion does not apply if such discharge, dispersal, release, or escape is sudden and accidental. \textit{Id. See generally} Salisbury, supra note 16 (discussing the "pollution exclusion" appearing in the CGL); Tyler & Wilcox, supra note 25 (analyzing the pollution exclusion's effectiveness in avoiding coverage for environmental damage claims); S. Hollis M. Greenlaw, \textit{Note, The CGL Policy and the Pollution Exclusion Clause: Using the Drafting History to Raise the Interpretation Out of the Quagmire}, 23 \textit{COLUM. J. L. \\& SOC. PROBS.} 233 (1990) (examining the drafting history and three judicial interpretations of the pollution exclusion).

\textsuperscript{10} See supra note 24.

\textsuperscript{11} See supra notes 66-82 and accompanying text.

\textsuperscript{12} See, e.g., DRI, supra note 40; Tinker, supra note 5. Neither of these commentators predicted that the new definition would affect or eliminate coverage of incorporation damage.

\textsuperscript{13} See supra notes 101-02.
is both property damage in and of itself and a measure of the damage done by incorporating a defective product.\textsuperscript{114} Although courts and commentators influenced by \textit{Hauenstein} commonly speak of "diminution in value" as CGL-covered property damage,\textsuperscript{115} that construction is logically and intuitively unsound.\textsuperscript{116}

Such "coverage" would actually be an empty gesture. Consider the following: Because substantive tort law largely prohibits defective product purchasers from recovering for pure economic loss, a manufacturer will likely incur liability for such loss, if at all, only in contract.\textsuperscript{117} But since \textit{Geddes & Smith} in 1959, courts have repeatedly

\begin{itemize}
\item \textsuperscript{114} For text of the confusing language and examples of conflicting interpretations, see \textit{supra} notes 52-53.
\item \textsuperscript{115} \textit{See}, \textit{e.g.}, Vasichek, \textit{supra} note 101, at 813 n.90 (stating that "diminution in value clearly constituted 'property damage' under the 1966 revisions").
\item \textsuperscript{116} A federal district court judge commented as follows on the contention that diminution of value can itself constitute property damage:

[Plaintiff's] theory (and that of its supporting authorities) of property damage, that is, that an occurrence results in a diminution in market value of tangible property, there one has property damage, falls of its own weight.

Assume real property, say a dwelling house, belonging to a governor of a State. Real estate agents will readily and properly testify that such property is increased in market value because its seller would be a governor. Assume the governor is impeached. This occurrence (or its basis) would result in a diminution of the fair market value of the dwelling. Aside from the question of liability, [plaintiff] would have to argue that the impeachment resulted in property damage, as it defines that term in its brief. Indeed, under [plaintiff's] argument, \textit{any} occurrence, be it a raise in interest rates, a war, or a strike in a dominant industry, which diminishes property values, meets the definition sought to be imposed by [plaintiff]. Such coverage could not have been contemplated by the parties.

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To further illustrate this distinction, consider the case of the owner of an office building who has just discovered that in 1950 great quantities of asbestos insulation were installed around the pipes. If incorporation of a defective product is property damage, then the building was initially damaged 43 years ago. But if declining market value is the deciding factor, there has been no property damage (assuming that no one knew of the asbestos before the owner). In fact, under the diminution in value scheme, property damage would only occur when the local real estate market learns of the asbestos, perhaps in next week's newspapers, perhaps when the building is sold, perhaps never.

\begin{itemize}
\item \textsuperscript{117} "Pure economic loss," which is generally not recoverable in a negligence action, is defined as a "financial loss which is not causally consequent upon physical injury to the plaintiff's own person or property." \textit{Bruce Feldthussen, Economic Negligence} 1 (2d ed. 1989). By contrast, "consequential economic loss" is defined as financial loss that is causally consequent on physical damage. \textit{Id}.

Prosser and Keeton observe that traditionally, product purchasers could not recover for "intangible commercial loss" in negligence or strict liability, and that the few cases allowing such recovery would most properly be treated as sounding in contract. W. PAGE \textit{Keeton et al., The Law of Torts} 708 (5th ed. 1984). They note also that product purchasers who are victims of intentional torts such as fraud may recover intangible
held that the CGL policy language covers property damage liability only if the liability sounds in tort. So a CGL policy that purports to cover diminution, which can be pure economic loss, as "property damage," thereby purports to cover a tort "liability" with little or no basis in law. The CGL drafters were not likely to have set out to create such a policy.

In contrast, it is rudimentary that an insured can be liable in tort for actually physically damaging property and thereby causing its value to fall. Knowing this, reasonable parties to an insurance contract are far more likely to consider diminished value to be a measure of damages rather than damage itself. Accordingly, Hauenstein and its progeny are best understood to stand for the proposition that diminution in market value is a measure of property damage, not damage itself.

commercial losses. Id. But the typical incorporation suit will not involve intentional wrongdoing.

See also Stone & Webster, 458 F. Supp. at 796 n.1 (suggesting that it is unlikely that an insured will be held liable for mere property value decline).


119. See Stone & Webster, 458 F. Supp. at 796 n.1 (demonstrating how diminished market value can be pure economic loss).

120. See Eljer, 972 F.2d at 811 (stating there is "little demand" for liability insurance covering liability for causes of action that are not widely recognized).

121. See Eljer, 972 F.2d at 811 ("Under traditional tort law, if you hit a bridge and put it out of commission, you are liable to the owner of the bridge . . . .")

122. To illustrate, in Missouri Terrazzo Co. v. Iowa Nat'l Mut. Ins. Co., 740 F.2d 647, 649 (8th Cir. 1984), a floor deteriorated after being improperly installed in a supermarket. The company that installed the floor sought CGL coverage for its settlement with the supermarket, but the insurer denied coverage on the ground that diminution in value is not covered under the post-1973 definition of property damage. Id. The court agreed with the insured flooring company that diminution in value is "merely a means of measuring the damage sustained as a result of the property damage." Id. at 650.

123. See John P. Arness & Randall D. Eliason, Insurance Coverage for "Property Damage" in Asbestos and Other Toxic Tort Cases, 72 VA. L. REV. 943, 953-55 (1986) (reading Hauenstein to say that incorporation of a defective product, rather than decreased market value, constitutes the property damage). But see, Larry Spurgeon, Determining the Scope of "Bodily Injury or Property Damage" Under the Comprehensive General Liability Policy, 23 IDAHO L. REV. 379, 396 (1987) (stating that Hauenstein is the leading case for the proposition that diminished value of property is, in and of itself,
The primary fault of the flawed "diminution is damage" view is that it may lead courts to reflexively and incorrectly preclude coverage in defective product incorporation cases. To illustrate, a court that views diminution as damage will likely also classify it as intangible damage. If the court further views the 1973 definition as eliminating coverage for intangible damage, the court could reflexively find no coverage for incorporation claims. This fixation on diminution as intangible damage could divert the court's attention from where it properly should be: whether or not there was a physical injury. If the court instead took the correct view that diminution is the measure of the damage caused when a defective product is incorporated into a larger entity, and that such incorporation is a "physical injury," the court would then find incorporation damage covered under post-1973 policies.

V. PROPOSAL

The post-1973 CGL form should be read to cover damages from the incorporation of defective products into larger entities. The primary change made to the property damage definition in 1973—the addition of the term "physical"—did not eliminate the coverage for incorporation damage held to exist under the pre-1973 policies. Rather, the word "physical" in the post-1973 policies should be read to exclude coverage for purely economic losses—losses which, unlike incorporation, involve no physical contact.

Granted, no one would seriously maintain that adding the word "physical" to the 1973 definition of property damage had no effect.

124. See, e.g., American Home. Assur. Co. v. Libbey-Owens-Ford Co., 786 F.2d 22, 25 (1st Cir. 1986) (stating that under the 1973 definition "courts have held that intangible damages, such as diminution in value, are not considered property damage"); Wyoming Sawmills, 578 P.2d at 1256 (referring to depreciation in property value as "intangible" damage).

125. See, e.g., American Home, 786 F.2d at 25 (stating that the 1973 CGL policy drafters "expressly added the modifier 'physical' injury to the definition of 'property damage' in order to restrict recovery for intangible losses"); Wyoming Sawmills, 578 P.2d at 1256 (stating that the only possible reason why the drafters added "physical" to the 1973 definition was to exclude coverage for "consequential or intangible damage" (quoting ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE §11.09 (1976))).

126. See infra note 144 (positing that defective product incorporation inherently involves physical contact).

127. See infra part V.

128. See OBRIST, supra note 105, at 40.
"Physical" narrows coverage in some way by indicating that non-physical injuries that were covered by previous policies will not be covered. But the "physical" qualifier should not limit coverage to the extent the courts have maintained. Rather, the proper interpretation of the "physical" limitation is rooted in the long-recognized distinction in tort law between liability for economic losses involving some physical injury, and economic losses involving no physical injury.129 Such is the line the drafters of the 1973 policy apparently intended to draw.

Tort law recognizes a general duty to refrain from acts that unreasonably threaten physical injury or property damage.130 But there is no general duty of care, and hence no ground for recovery, when the threatened harm is entirely economic.131 This requirement of physical injury plays an important role in restricting recovery for "pure economic loss."132

There is perhaps no better illustration of this point than the famous case of In re Petition of Kinsman Transit Co.133 In Kinsman, a ship broke free from its river mooring and struck another ship, causing the second ship's mooring to break also.134 The two ships continued down the river together, striking a bridge, starting an ice jam, and ultimately causing a flood that disrupted river traffic.135 The court allowed claims by an owner of property damaged by the flood on the ground that such damage was reasonably foreseeable.136 But the court rejected claims based on disruptions in cargo unloading, stressing that

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129. As one commentator put it:
Even though the broad scope of the general rule restricting liability for the economic consequences of negligence, there are circumstances in which courts do impose such liability. The most common circumstance in which courts permit recovery of economic loss is where there is also some physical injury. Indeed, a common statement of the general rule is that there can be no recovery for economic loss in the absence of some physical injury.


130. See In re Petition of Kinsman Transit Co., 338 F.2d 708, 723-25 (2d Cir. 1964) (holding that this general duty of care extends to all consequences, even the novel or remote).

131. See Note, Economic Loss in Products Liability Jurisprudence, 66 Colum. L. Rev. 917, 944 (1966) [hereinafter Economic Loss].

132. See Feldthussen, supra note 117, at 1.

133. There are two Kinsman decisions, In re Petition of Kinsman Transit Co., 338 F.2d 708 (2d Cir. 1964) [hereinafter Kinsman I] and Kinsman Transit Co. v. City of Buffalo, 388 F.2d 821 (2d Cir. 1968) [hereinafter Kinsman II]. For a discussion of Kinsman Transit, on which the discussion herein is based, see Feldthussen, supra note 117, at 218-21.

134. Kinsman I, 338 F.2d at 712.

135. Id. at 713; Kinsman II, 388 F.2d at 822.

136. Kinsman I, 338 F.2d at 723.
they were too "remote and indirect," and that as a practical matter, recovery needed to be limited. Commentators have since invoked this same pragmatic principle.

The significance of Kinsman is that the limited tort recovery it embraced parallels the coverage limits the insurance industry has built into CGL policies. Achieving Kinsman-like limits on insurance coverages is therefore a likely impetus for the 1973 change in the property

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137. Kinsman II, 388 F.2d at 824.
138. Id. at 825 n.8.
139. See, e.g., Fleming James, Jr., Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal, 25 VAND. L. REV. 43, 45 (1972) (asserting that the physical consequences of liability are usually limited but the indirect repercussions of negligence may be unacceptably open-ended).

Another commentator observed:

The physical consequences of an automobile accident, for example, are necessarily restricted to persons and property within some limited physical proximity. However, no such inherent limitation exists with respect to the economic consequences. Instead, the physical injuries suffered by the initial victims could set off a chain reaction of economic repercussions extending to an unlimited number of parties. As a result, liability for the economic consequences of negligence raises the fear of "liability in an indeterminate amount for an indeterminate time to an indeterminate class."

Gaebler, supra note 129, at 612 (quoting Judge Cardozo's famous formulation in Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931)).

140. In a discussion of East River S.S. Corp. v. Transamerica Delaval Inc., 476 U.S. 858 (1986), one commentator recently wrote:

While it is true that the principles that determine whether particular losses qualify as tort damages are not coterminous with principles that determine whether losses are insured under liability policies, there is nonetheless a close parallel between those principles. This parallel can clearly be seen in the following standard CGL exclusion:

[Coverage does not extend to] loss of use of tangible property which has not been physically injured or destroyed resulting from (1) a delay in or lack of performance by or on behalf of the Named Insured of any contract or agreement, or (2) the failure of the Named Insured's products or work performed by or on behalf of the Named Insured to meet the level of performance, quality, fitness or durability warranted or represented by the Named Insured; but this exclusion does not apply to loss of use of other tangible property resulting from the sudden and accidental physical injury to or destruction of the Named Insured's products or work performed by or on behalf of the Named Insured after such products or work have been put to use by any person or organization other than an Insured.

As the Supreme Court noted in Delaval, 106 S. Ct. at 2301, one of the intermediate positions [between allowing recovery for all economic losses and no economic losses] ... would allow a tort recovery for damage to the product itself and for loss of use of other [tangible] property if the damage is sudden.

Ed Bluestein, Jr., Damages in Maritime Products Liability Cases, 62 TUL. L. REV. 511, 541 n.146 (1988); see also Eljer, 972 F.2d at 811-12.
damage definition. Indeed, court rulings have directly influenced the drafting of CGL policies in other contexts, and insurers have avoided extending coverage to liability for consequential economic losses such as those held non-actionable in Kinsman. In fact, insurers may even consider pure economic losses too "elusive" to cover at all. At the very least, economic losses can be very difficult to insure.

Furthermore, CGL policy drafters have previously restricted coverage of pure economic losses by altering the policy definitions section. As discussed above, in 1966 the drafters inserted the qualifier "tangible" before the term "property." This came in the wake of courts interpreting the unqualified term expansively, concluding for example that if unqualified, "property" can reasonably include "obligations, rights and other intangibles." By requiring damage to "tangible" property in the 1966 form, the insurance industry effectively precluded courts from finding coverage for injury to productivity,

141. See Eljer, 972 F.2d at 811 (stating that the structure of the 1973 definition may have been influenced by substantive tort law).
142. See supra note 34 and accompanying text.
143. See Economic Loss, supra note 131, at 955 (suggesting that product policy exclusions for various unspecified forms of economic losses indicate an unwillingness to underwrite such risks).
144. One commentator has noted "[t]he feeling [in the insurance industry] is that claims based on loss of profits, loss of good will, loss of business reputation, etc., are too elusive and illusory to be the proper subject of insurance, at least if not associated with property damage [involving actual physical damage] to tangible property." Ray H. Anderson, Current Problems in Products Liability Law and Products Liability Insurance, 31 INS. COUNS. J. 436, 446 (1964).
145. Insurers rely heavily on their ability to predict losses accurately. Vasichek, supra note 101, at 802 n.30. Economic losses are very difficult to predict. Economic Loss, supra note 131, at 956. Losses can vary markedly depending on the size and nature of the ultimate user. Defective circuit breakers, for example, could cause far more loss of profit for a major electrical utility than for a small retailer. Id.
146. Vasichek, supra note 101, at 801-803. Although new definitions have in fact restricted coverage, finding direct evidence of the drafters' intent is a painstaking and complex matter. As already noted, insurance companies concede that materials relating to drafting history are not published or released, and their content can thus only be ascertained by deposing the drafters. See supra note 99. This allows insurers to play both sides of the fence. On the one hand, insurers know that deposing drafters or otherwise acquiring first-hand evidence can be cost-prohibitive. On the other hand, insurers can attack secondary sources, even those widely used and generally accepted, as irrelevant to the drafting. See Petition for Writ of Certiorari to the Supreme Court of the United States at 17-18, Eljer Mfg. v. Liberty Mut. Ins. Co., 972 F.2d 805 (7th Cir. 1992) (No. 92-1312).
147. OBRIST, supra note 105, at 40.
copyrights, and other purely economic interests. Nevertheless, the 1966 definition still left insurers potentially liable for pure economic losses as long as "tangible" property was injured. So in 1973 insurers had a strong incentive to try to reduce their exposure to such losses by requiring physical contact in cases of property damage. In fact, nearly a decade earlier, one commentator had suggested adding "physical" to the CGL property damage definition to reduce insurer exposure to tangential economic losses. All this leads to the conclusion that rather than attempting to eliminate incorporation coverage, the 1973 drafters, like the 1966 drafters, were trying to restrict coverage of pure economic losses.

149. See Tarpey, supra note 34, at 227 (stating that the tangible property requirement "apparently is designed to exclude liability for certain consequential damages, such as loss of profits, goodwill, as well as damage to other intangible property, such as patents, trade names, trade secrets, etc."); Wendorff, supra note 19, at 255 (allowing that the tangible property definition will preclude coverage for loss of profits, lost goodwill and other economic losses, but arguing that insurers never intended to cover those losses anyway); Vasichek, supra note 101, at 802 n.30 (stating that "[t]he insurance industry's decision to avoid further application of the Labberton 'obligations, rights and other intangibles' reasoning is understandable").

150. Vasichek, supra note 101, at 801. To illustrate how this worked, consider the recent spate of syringes allegedly found in soft drink cans. "Tangible" property was harmed immediately: millions of cans were rendered unfit for sale. But another non-physical injury, that being to the drink manufacturer's good name, presented potential for tremendous pure economic losses.

151. See Anderson, supra note 144, at 446. Examining Anderson's thinking in detail should help reassure skeptical readers that the reading of physical this Comment proposes is not some law school flight of fancy. Anderson was an assistant counsel at Employers Mutual of Wausau and wrote this article in 1964 for an audience of other insurance company lawyers. Toward the end of his state-of-the-field article he detailed some reservations that insurance companies had about three separate liability scenarios, each apparently a combination of the real and the hypothetical. Id.

In the first, a neighborhood tavern was ultimately put out of business after a customer found a dead mouse in his beer bottle and spread the word about his misfortune. Id. Obviously a defective product, but no physical damage to anything but the product itself.

In the second, a boat motor broke down, and by the time the commercial fisherman could get it repaired, he had missed most of the fishing season. Id. Again, defective product, but no physical damage to anything but the product itself.

The third case involved a company that made fire extinguishers. An extinguisher sold to a boat owner failed to operate, not causing any physical damage itself but permitting fire to consume the boat. Id.

Anderson asserted that all that would be needed to make clear that CGL policies did not cover such damage would be to insert "physical" before "damage to tangible property." Id. This is not to suggest that Anderson's position squares completely with the views in this Comment. In fact, Anderson maintained that adding "physical" would preclude coverage in the boat motor example—a clear case of defective product incorporation. This comment does suggest, however, that "physical injury" was understood by some in the insurance industry as far back as 1964 as a way to limit coverage for economic losses like lost good will and lost profits.
The best-reasoned interpretation of the post-1973 policies, then, is that they provide coverage when there is some physical contact and restrict coverage only when there is none. Physical contact ought to be the deciding factor. Incorporation of a defective product into a larger entity is virtually certain to involve physical contact. Accordingly, incorporation of a defective product should be covered property damage under the post-1973 policies.

Insurance companies will no doubt argue that this reading of the property damage definition renders "physical" meaningless as a qualifier to "injury." But the reading advocated here will still screen out some of the more tangential injuries that insurance companies had to cover under the 1966 definition and sought to avoid covering with the 1973 definition. This reading will also preserve exclusion of coverage for "injuries" that are essentially lost investment opportunities or pure diminution in value. Under this reading, then, "physical" is

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152. This distinction animated much of the dispute between the majority and dissenting opinions in Eljer, supra notes 84-99.

153. Contact is "the touching of two objects or surfaces." WEBSTER'S NEW RIVERSIDE DICTIONARY 303 (2d ed. 1988). To incorporate is "to unite with or introduce into something already existent [usually] so as to form an indistinguishable whole that cannot be restored to the previously separate elements without damage." WEBSTER'S THIRD INTERNATIONAL DICTIONARY 1145 (unabridged 1986). These definitions confirm what common sense suggests: Incorporation of a defective product into another entity consists of a physical union achieved through physical contact. See also Eljer, 972 F.2d at 810 (observing that the 1973 CGL policy was meant to cover liability resulting "from physical contact . . . as when a potentially dangerous product is incorporated into another" and to preserve coverage of cases involving "physical touching, as where a defective water system is installed in a house").


154. See supra note 106 and accompanying text.

155. See, e.g., Hartford Acc. & Indem. Co. v. Case Found. Co., 294 N.E.2d 7 (Ill. App. Ct. 1973). In this case, several insureds (including an architectural firm and contractors) sought CGL coverage to defend a negligence suit by the developer of the John Hancock Center. Id. at 9. The court rejected the insureds' argument that the developer's losses of investment and anticipated profits caused by the insureds' delays were "injuries" covered by the CGL. Id. at 13-14. Granted, this damage was quintessentially economic and the court denied coverage even under the 1966 wording ("injury to or destruction of property"), but the case illustrates the nature of injuries properly excluded as
anything but meaningless.

VI. CONCLUSION

Insurers responded to increasingly costly interpretations of the CGL policy by restricting the definition of "property damage" in 1973. Insurers appear to have been understandably attempting to reduce their nearly limitless potential exposure to pure economic losses. But insurers did not act to withdraw coverage for the incorporation of defective products. Until they do, the courts should not act for them. Incorporation of defective products ought to be recognized as covered property damage under the post-1973 CGL policy.

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