PRODUCTS LIABILITY
CONSUMER CLASS ACTION CLAIMS: WHEN ARE THEY COVERED BY INSURANCE?

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I. INTRODUCTION

Whether insurance coverage exists under a CGL policy for a product liability class actions often depends on whether there is an “occurrence” as required by the policy, whether “property damage” or “bodily injury” has occurred, and whether there are any potentially applicable exclusions.

II. THE CGL POLICY AND COMMON PROVISIONS AT ISSUE

The typical CGL policy at issue contains the following potentially relevant provisions:

**COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY**

1. **Insuring Agreement**
   a. We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. We will have the right and duty to defend the insured against any “suit” seeking those damages. However, we will have no duty to defend the insured against any “suit” seeking damages for “bodily injury” or “property damage” to which this insurance does not apply. We may, at our discretion, investigate any “occurrence” and settle any claim or “suit” that may result. But:
      
      (1) The amount we will pay for damages is limited as described in Section III - Limits Of Insurance; and
      
      (2) Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A or B or medical expenses under Coverage C.

      No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under Supplementary Payments -- Coverages A and B.

   b. This insurance applies to “bodily injury” and “property damage” only if:

      (1) The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory”;

      (2) The “bodily injury” or “property damage” occurs during the policy period; and

      * * *

The policy contains the following potentially applicable exclusions:

2. **Exclusions**
This insurance does not apply to:

a. **Expected Or Intended Injury**

“Bodily injury” or “property damage” expected or intended from the standpoint of the insured. This exclusion does not apply to “bodily injury” resulting from the use of reasonable force to protect persons or property.

b. **Contractual Liability**

“Bodily injury” or “property damage” for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:

(1) That the insured would have in the absence of the contract or agreement; or

(2) Assumed in a contract or agreement that is an “insured contract”, provided the “bodily injury” or “property damage” occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an “insured contract”, reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be damages because of “bodily injury” or “property damage”, provided:

(a) Liability to such party for, or for the cost of, that party’s defense has also been assumed in the same “insured contract”; and

(b) Such attorney fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.

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k. **Damage To Your Product**

“Property damage” to “your product” arising out of it or any part of it.

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m. **Damage To Impaired Property Or Property Not Physically Injured**

“Property damage” to “impaired property” or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in “your product” or “your work”; or
(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to “your product” or “your work” after it has been put to its intended use.

n. Recall Of Products, Work Or Impaired Property

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 follow definitions may be at issue:

SECTION V -- DEFINITIONS

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3. “Bodily injury” means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

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8. “Impaired property” means tangible property, other than “your product” or “your work”, that cannot be used or is less useful because:

a. It incorporates “your product” or “your work” that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by the repair, replacement, adjustment or removal of “your product” or “your work” or your fulfilling the terms of the contract or agreement.

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13. “Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.
17. “Property damage” means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it.

For the purposes of this insurance, electronic data is not tangible property.

As used in this definition, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.

III. IS THERE AN OCCURRENCE?

A. Expected Or Intended Injury

In order for coverage to apply, bodily injury or property damage must be caused by an occurrence, defined as an “accident.” Intentional conduct is generally not an occurrence.

There is no occurrence where “bodily injury” or “property damage” is expected or intended from the standpoint of the insured. For example, if the insured has fraudulently sold a product knowing that it could cause damage or injury to buyers, a court could find no “occurrence.” The court in Liberty Mutual Insurance Co. v. Pella Corp. determined whether the policy covered the underlying class action litigation in which the complaint alleged that the insured “sold its windows with the knowledge of both the existence of the alleged defect, and that there was a possibility that the defect would result in damage.” The court concluded that, because the underlying actions did not “clearly and unambiguously allege” that the insured “expected” the defect to cause damage, a scenario that would be not be covered under the

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1 631 F.Supp.2d 1125, 1133 (S.D. Iowa 2009), aff’d 650 F.3d 1161 (8th Cir. 2011) (emphasis in original).
policy, there was still a potential that the insured could be found liable for damage caused by an “occurrence” under the policy.²

B. Whether The Underlying Action Presents A Single Occurrence Or Multiple Occurrences Under The Policy

Another question facing insurers when assessing coverage of claims is whether each claim constitutes a separate occurrence or are part of a single occurrence. This issue arose in Sunoco, Inc. v. Illinois National Insurance Co., where the insured was self-insured up to $250,000 per occurrence and up to an aggregate of $5,000,000.³ The insured was a defendant in numerous lawsuits asserting claims based on its manufacture and distribution of gasoline containing methyl tertiary-butyl ether (MtBE), an additive that was originally thought to reduce the amount of carbon released into the air during the burning of gasoline.⁴ Because the insured had not spent more than $250,000 on each claim in the underlying lawsuits, the claims would need to be deemed to arise from a single occurrence in order to invoke the insurer’s duty to defend.⁵ The court concluded that, although the claims underlying the lawsuits were not identical, each claim alleged the same cause of action and therefore arose from a single occurrence.⁶

IV. HAS THERE BEEN PROPERTY DAMAGE AS REQUIRED BY THE POLICY?

If coverage is sought for property damage claims under a CGL policy, the policy requires there be actual physical injury to property or persons. In Amtrol, Inc. v. Tudor Insurance Co., a class action suit alleging that insured’s leaking water heaters were “defective” and “dangerous” products that caused property damage and posed a risk of bodily injury, the court found that the insured was not entitled to summary judgment because “in order to meet the physical damage requirement, one must show that the water has somehow exacted a physical harm upon tangible property that required remediation or otherwise

² Id. at 1133-34.
³ 226 F. App’x 104, 107 (3rd Cir. 2007).
⁴ Id. at 105.
⁵ Id. at 107.
⁶ Id. at 108.
diminished the value of the property itself. . . . [and a] leak that results in no damage beyond the mere presence of water that can be removed or evaporates without harm does not constitute property damage.”

The court denied the insured’s motion on that theory because the insured did not produce any evidence of actual water damage caused by water leakage. The court also concluded that the insured’s request for mitigation costs was not covered under the policy for two reasons: (1) the costs incurred by the insured were attributable to the insured’s warranty program on the product “and not directly because of an interest in mitigating property damage or reducing their liability” and (2) “[t]he vast majority of the damages incurred by Amtrol were for repair and replacement costs, a form of first party liability that CGL policies are not designed to cover. . . . [w]hile reimbursement for such first party liability may be acceptable when the product causes actual third party damage, it stretches the analogy too far to allow coverage based on the prevention of potential property damage.”

A. Must Allege Damage To Tangible Property

In cases where the underlying complaint involves claims of property damage, the courts look to the nature of the damage and the allegedly damaged property to determine whether coverage exists. For example, in America Online, Inc. v. St. Paul Mercury Insurance Co., the plaintiffs in the underlying suit alleged that AOL 5.0 was a defective product and that the defect in the product caused physical damage to customers’ tangible property, which the complaint defined as taking “the form of computers, computer data, software and systems.” The court first held that “computer data, software and systems are not ‘tangible’ property in the common sense understanding of the word” because, contrary to the plain and ordinary meaning of “tangible” property (“property that can be touched”), “[c]omputer data, software and systems are incapable of perception by any of the senses and are therefore intangible.”

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8 Id.
9 Id. at *8.
11 Id. at 462.
Paul had no duty to defend AOL against allegations of damage to the underlying plaintiffs’ computer data, software, and systems because such damage was not covered under the policy. The court went on to state that St. Paul generally would have a duty to defend AOL against claims of damage to the computers themselves “because it is obviously a tactile, corporeal item” and therefore could potentially be covered by the insurance policy. But the court clarified that, due to the nature of the damage to the computers (loss of use versus physical damage to the objects themselves), the impaired property exclusion applied. Under the policy, “impaired property” was defined as “tangible property, other than [AOL’s] products or completed work, that can be restored to use by nothing more than: [1] an adjustment, repair, replacement, or removal of [AOL’s] products or completed work which forms a part of it; or [2] [AOL] fulfilling the terms of a contract or agreement.” The exclusion barred coverage for any “property damage to impaired property, or to property which isn’t physically damaged, that results from: [1] [AOL’s] faulty or dangerous products or completed work; or [2] a delay or failure in fulfilling the terms of a contract or agreement.” The court concluded, therefore, that St. Paul had no duty to defend AOL against the underlying claims of damage to either the computers themselves (the impaired property) or the computer data, software, or systems (the intangible property).

B. When Does Damage Occur?

The issue of whether the property damage took place during the policy period is especially relevant in cases where the underlying lawsuit alleges that the insured sold a defective product for installation into the real or personal property of the buyer and the damage does not occur until later. The question then becomes is the installation of the defective product “property damage” under the policy or does the buyer have to suffer actual damage during the policy period?

12 Id.
13 Id. at 470.
14 Id. (alterations in original).
15 Id. (alterations in original).
16 Id.
Many insurers would argue that the policy in place at the time the actual property damage occurs is the only potentially applicable policy. However, be aware of the decision in *Eljer Manufacturing, Inc. v. Liberty Mutual Insurance Co.*\(^\text{17}\) In *Eljer*, the plaintiffs in the underlying litigation alleged that the insured’s plumbing system leaked, and repairing or replacing the plumbing systems required breaking through floors, ceilings, or walls because they were integrated into plaintiffs’ homes.\(^\text{18}\) The policy defined “property damage” as “physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom” or the “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.”\(^\text{19}\) The insurer and insured disagreed about when the injury actually occurred – the insurance policy was in effect at the time of the installation of the plumbing systems, but not at the time of the discovery of the leaks. The court determined that the drafters of the policy intended that an occurrence under the policy is “a loss that results from physical contact, physical linkage, as when a potentially dangerous product is incorporated into another and, because it is incorporated and not merely contained . . . , must be removed, at some cost, in order to prevent the danger from materializing.”\(^\text{20}\) The court finally concluded that, “incorporation of a defective product into another product inflicts physical injury in the relevant sense on the latter at the moment on incorporation” and that, because the policy was in effect at that time, the insurer had a duty to defend the insured.\(^\text{21}\)

\(^\text{17}\) 972 F.2d 805 (7th Cir. 1992).
\(^\text{18}\) *Id.* at 807.
\(^\text{19}\) *Id.*
\(^\text{20}\) *Id.* at 810.
\(^\text{21}\) *Id.* at 814.
V. THE FORM OF THE PLEADINGS MAY AFFECT COVERAGE

A. The Prayer For Relief

The courts have reached conflicting decisions regarding whether the pleadings contained allegations sufficient to trigger coverage based upon the prayer for relief contained in the complaint. In *HPF, L.L.C. v. General Star Indemnity Co.*, the Illinois Court of Appeals reversed the lower court ruling that General Star breached its duty to defend it insured, HPF, holding that the complaint in the underlying action failed to allege facts falling within (or potentially within) coverage because “the core of [the underlying] claim is that HPF misled the public that its Herbal Phen–Fen products were proven safe and effective for the treatment of obesity, when in fact, those products were not approved. The [underlying] complaint does not seek damages for any sickness or injury caused by ingesting HPF’s herbal products; it seeks injunctive remedies for the misrepresentation of the quality and effectiveness of the products.”

It addressed the fact that the plaintiffs in the underlying complaint requested that the court establish a medical monitoring fund, stating that this request did not bring the underlying complaint within or potentially within coverage because it was a prayer for relief rather than an allegation of bodily injury. The court declined to presume that the underlying complaint therefore alleged that the products caused bodily injury.

In *Omega Flex, Inc. v. Pacific Employers Insurance Co.*, however, the Massachusetts Court of Appeals specifically stated that courts should “look at the entire complaint, including the prayer for relief, in order to determine whether the allegations are reasonably susceptible of stating a claim that would fall within the zone of covered injuries.” The insured manufactured and sold a corrugated stainless steel tubing that for installing into floors, walls, and attics of residential, commercial, and industrial properties to transmit

23 *Id.* at 918, 788 N.E.2d at 758.
24 *Id.*
gas to gas-fueled appliances. The plaintiffs in the underlying action alleged that “CSST was designed, manufactured, marketed, sold, distributed, and/or placed into the stream of commerce without sufficient thickness to protect against combustion after a lightning strike” and sought damages to provide protection from the alleged defect, as well as to provide notice to class members whose properties already had been damaged so that they could seek additional payment for their loss. The prayer for relief specifically requested

c) . . . award an amount equal to the cost to install lightning strike protection and insulation to stop lightning strikes from contacting the premises and/or install appropriate grounding of the pipes, thereby preventing the CSST piping from causing fires . . .;

d) Awarding such equitable relief permitted, including an injunction requiring Defendants to notify all Class Members that they are entitled to submit an additional or supplemental request for payment in connection with their prior loss and/or damage to their structure and/or premises . . .

The court there recognized that injunctive relief by itself does not constitute “damages” within the scope of coverage, but clarified that “injunctive relief that requires the insured to incur costs to remedy covered losses is ‘damages’ within the scope of the policy.”

B. Amendments May Add Potentially Covered Claims

The United States District Court, Northern District of California recently held that the allegations in a complaint could put an insurer “on notice of the potential for coverage under the terms of the policy.” The underlying action alleged that the insured’s Bluetooth Headsets can cause noise induced hearing loss and the packaging lacks adequate warnings about such potential hearing loss. The underlying action sought “damages for economic injury and [did] not seek damages for any physical injury that may have

26 Id. at 263, 937 N.E.2d at 55.
27 Id.
28 Id. at 263-64, 937 N.E.2d at 55.
29 Id. at 267, 937 N.E.2d at 57.
31 Id. at *1.
been sustained by Class members.”32 The court found that “the underlying actions in this case go to great length to describe the noise-induced hearing loss risk engendered through extensive use. . . . [and] [b]ecause allegations in the underlying actions traced covered claims that could be added through amendment, the underling complaint[‘]s amendment to seek damages because of bodily injury was not speculative.”33 The court found that, because such amendments were not speculative and because the insurer had notice that the allegations supported such claims, the insurer had a duty to defend the insured.

C. What If The Underlying Action Does Not Seek Recovery For Bodily Injury Or Specifically Disclaims Recovery For Bodily Injury?

It is not uncommon that, in order to achieve the uniformity necessary for certification as a class, a class action may expressly reject relief for bodily injury or property damage. While this should mean there is no coverage, a few courts have found coverage despite the absence of potentially covered allegations. In Zurich American Insurance Co. v. Nokia, Inc., the Texas Supreme Court addressed coverage questions presented by an underlying class action lawsuit wherein the plaintiffs alleged that radio frequency radiation from cell phones caused “biological injury.” The plaintiffs sought damages specifically, but not exclusively, in the form of headsets to minimize exposure to the harmful radiation.34 The court there considered that “[t]he lengthy complaints assert that the named plaintiffs were exposed to [radiation] from their phones and thus were subjected to ‘[the radiation]’s biological effects and the risk to human health arising therefrom’ and then discuss numerous studies linking RFR to adverse health consequences, including changes in the brain, headaches, heating behind the ear, sleep problems, and production of high levels of ‘heat shock proteins.’”35 The court then concluded that, in alleging “biological injury” from the radiation, the plaintiffs in presented claims that could potentially fall within coverage.36 The court also

32 Id.
33 Id.
34 268 S.W.3d 487, 489 (Tex. 2008).
35 Id. at 492.
36 Id. at 493.
concluded that, because the claim for damages was based on the plaintiffs’ exposure to radiation, it fell within coverage as alleging claims for bodily injury.\textsuperscript{37}

But the court in \textit{Steadfast Insurance Co. v. Purdue Federick Co.} came to a different conclusion. There, the underlying actions alleged deceptive marketing practices allegedly leading to addiction and abuse of the drug OxyContin. The class specifically excluded those seeking damages for bodily injury from the class.\textsuperscript{38} The court found no duty to defend, explaining that “[u]ltimately persuasive is the lack of any evidence in the above pleadings to indicate even the possibility that the plaintiffs seek damages ‘because of bodily injury.’ . . . . A careful review of [one] amended complaint shows that the relief sought is restitution/disgorgement of Oxycontin-related profits, injunctive relief and attorney’s fees. Restitution is certainly a type of money damages, but a fair reading of the pleading is that restitution is sought to compensate for allegedly wrongful marketing and promotional activities, not bodily injury. In [the other complaints], the allegations . . . expressly exclude claims of damages for bodily injury.”\textsuperscript{39}

In \textit{Medmarc Casualty Insurance Co. v. Avent America, Inc.}, the insured argued in the underlying litigation that the plaintiffs’ complaint did not allege any bodily injury stemming from various products the insured manufactured and sold that contained Bisphenol–A (BPA), but then alleged in the coverage litigation that the underlying action triggered the duty to defend because the “underlying complaints state claims for damages ‘because of bodily injury.’”\textsuperscript{40} The court found that the insured was not judicially estopped from making this seemingly conflicting argument, but that it was not a convincing argument when applied to the duty to defend. The court found that the insurer had no duty to defend because the underlying complaints did not allege that the defective products caused bodily injury but instead alleged that “the plaintiffs did not receive the full benefit of their bargain (because they now will not use the

\begin{footnotesize}
\begin{enumerate}
\item Id. at 494.
\item Id. at *3.
\item 612 F.3d 607, 613-14 (7th Cir. 2010).
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product) and therefore incurred purely economic damages unrelated to bodily injury.” The court concluded that even if the underlying plaintiffs proved every allegation in the complaint, they could not recover for bodily injury because they did not allege bodily injury. Because they could not recover for bodily injury, the insurer had no duty to defend the insured.

VI. ARE THERE APPLICABLE EXCLUSIONS?

A. Intentional Conduct By The Insurer

In *Compaq Computer Corp. v. St. Paul Fire & Marine Insurance Co.*, the underlying class action complaints alleged that Compaq intentionally sold computers that contained defective floppy-diskette controllers and floppy-diskette controller microcodes, and that these defective products caused the loss of use, corruption, and destruction of data.

While the relevant insurance policy was a Technology Errors and Omissions policy, rather than a CGL policy, it contained an exclusion for damage that the insured “expected or intended.” The policy covered certain errors (“any error, omission, or negligent act”) or events (“an ‘accident,’ including continuous or repeated exposure to substantially the same general harmful conditions”). The policies did *not* cover criminal, dishonest, fraudulent, or intentionally wrongful acts, or damage that the insured “expected or intended”. St. Paul denied coverage, citing the following facts in the underlying complaints:

1. the amended complaints alleged damages arising entirely from “intentional” conduct, which did not constitute an “error” under the Tech E & O policy;
2. the amended complaints sought to hold Compaq liable under the Computer Fraud and Abuse Act, 18 U.S.C. § 1030, a criminal statute that requires “knowing” and “intentional” conduct;
3. the injunctive, declaratory, and other equitable relief sought by the plaintiffs did not constitute “damages” that Compaq was legally required to pay; and
4. the amended

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41 Id. at 614.
42 Id.
43 Id. at 614-15.
45 Id.
46 Id.
complaints sought a refund of the purchase price, repair or replacement of the defective computer or component parts, and attorney fees and costs—none of which were covered “damages” as defined by the policy.\(^\text{47}\)

The court agreed, determining that, because the underlying complaints alleged intentional and knowing conduct by the insured, the insurer had no duty to defend because the intentional-acts exclusion of the policy clearly barred coverage.

**B. Product Recall Or “Sistership” Exclusions**

In *Hi-Port, Inc. v. Am. Int’l Specialty Lines Ins. Co.*, the court considered a claim by an insured that was in the business of providing contract chemical blending, packaging and distributing services that it was entitled to coverage under its CGL policy for a recall of a batch of antifreeze due to “a latent silicate fallout problem which occurred after the antifreeze had been packaged and distributed.”\(^\text{48}\) The court concluded that the antifreeze in question met the definition of the insured’s “product” under the policy.\(^\text{49}\)

The court then found that the policy’s “sistership” exclusion precluded coverage as the exclusion “applies to ‘product, work, or property’ ‘withdrawn or recalled from the market or from use . . . because of a known or suspected defect, deficiency, inadequacy or dangerous condition.’”\(^\text{50}\)

The sistership exclusion will not apply, however, where the insured does not attempt to remove the product from the market. In *Stark Liquidation Co. v. Florists’ Mut. Ins. Co.*, the court considered a dispute between an insurer and an insured where the insured sought coverage for damages arising from diseased apricot trees it sold to a third party.\(^\text{51}\) The relevant policy exclusion there stated that the insurance did not apply:

(a) To property damages to your products or your work performed arising out of such products, or any part thereof;

\(^{47}\) *Id.* at *2.*

\(^{48}\) 22 F. Supp. 2d 596, 597-98 (S.D. Tex. 1997) *aff’d*, 162 F.3d 93 (5th Cir. 1998)

\(^{49}\) *Id.* at 600.

\(^{50}\) *Id.* at 601.

\(^{51}\) 243 S.W.3d 385, 395 (Mo. Ct. App. 2007).
(b) To damages claimed for the withdrawal, inspection, repair, replacement or loss of use of:

(i) Your products;

... 

(iii) Any property of which such products or work forms a part, if such products, work or property are withdrawn from the market or from use because of a known or suspected deficiency of them.\(^{52}\)

The court held that the exclusion did not apply because the insured did not seek coverage for the trees themselves, nor did it recall the trees.\(^{53}\)

C. Impaired Property Exclusion

Courts will sometimes find that incorporation of a “potentially injurious material” into another product, causing loss to the products into which it is incorporated, constitutes property damage.\(^{54}\) *Shade Foods* involved the discovery of wood splinters in diced almonds processed by the insured but supplied by a third party. The policy in that case contained an exclusion for property damage to impaired property and defined “impaired property” as “tangible property, other than your product or your work that cannot be used or is less useful because: ... It incorporates your product or your work that is known or thought to be defective, deficient, inadequate or dangerous ... *if such property can be restored to use by . . . [t]he repair, replacement, adjustment or removal of your product.*”\(^{55}\) The court found that the exclusion did not apply because the product manufactured from the contaminated diced almonds could not be “restored to use”; at most, the insured could “salvage” the product for some other use but it was “fanciful to suppose that the nut clusters composed of congealed syrups and diced nuts or the boxed-cereal product containing

\(^{52}\) Id.

\(^{53}\) Id.


\(^{55}\) Id. at 866, 93 Cal. Rptr. 2d at 377 (emphasis in original).
the nut clusters could be somehow deconstructed to remove the injurious splinters and then recombined for their original use."^56

VII. OTHER ISSUES FOR CONSIDERATION

A. Voluntary Settlements By The Insured

Occasionally, an insured may voluntarily settle class action claims or a lawsuit, raising interesting issues for the insurer. In *Lloyd’s Syndicate No. 5820 v. AGCO Corp.*, the insured argued that Lloyd’s duty to indemnify arose at the time it sent a demand letter to the insurer seeking reimbursement of $410,000 in extended protection plan claims made by consumers of the insured’s product, a self-propelled, agricultural spray applicator.® Lloyd’s argued that the terms of the policy clearly stated that the duty to indemnify arose when the insured was “held legally liable” for the claims, and that the insured’s “voluntary reimbursement” of the claims before the entry of judgment was not covered.® The court agreed with the Lloyd’s, holding that the duty to indemnify could not be required until a court determined the insured’s legal liability for the underlying claims.

In *Federal Insurance Co. v. Binney & Smith, Inc.*, the insured settled the underlying action, which alleged breach of implied warranty of merchantability, violation of the Illinois’ Consumer Fraud Act and Uniform Deceptive Trade Practices Act, and breach of express warranty.® The insured settled the underlying claims, despite the finding that the product at issue (crayons) were safe and non-toxic, because it believed that “any reasonable estimate of the amount of an adverse jury verdict, multiplied by the possibility of it occurring, exceeded the amount for which it was anticipated Binney could settle.”® The

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^56 Id.; see also Eljer Mfg., Inc. v. Liberty Mut. Ins. Co., 972 F.2d 805 (7th Cir. 1992).


® Id. at 812, 756 S.E.2d at 525.

® *Federal Insurance Co. v. Binney & Smith, Inc.* is not a products liability class action, but insurers should be aware of potential liability when the insured voluntarily settles the underlying action.


® Id. at 283-84, 913 N.E.2d at 49.
insurer attempted to avoid the duty to defend and indemnify, arguing that the insured settled despite an “absolute defense” to the statutory claims against it and there was no potential that the other claims against it could be covered under the policy. The court agreed with the lower court’s ruling that the insured settled the underlying claims “in reasonable anticipation of potential liability in the underlying actions.” 62 After concluding that the settlement was reasonable, and therefore the insurer would have a duty to indemnify at least part of the settlement amount, the court remanded to the district court so that the insured could “define when the various class members who were part of the settlement actually purchased Crayola brand crayons, triggering the advertising injury at issue here . . . . [and the insurer] would then be responsible for the portion of the settlement damages that relates to injuries that occurred while the Federal policies at issue provided Binney with advertising injury coverage.” 63

B. Exclusions Will Not Create Coverage Where No Affirmative Coverage Otherwise Exists

While this seems like a simple proposition, in 2008, the Ninth Circuit ruled that carve-back provisions in a policy exclusion do not create coverage where coverage does not otherwise exist in the first instance. In Sony Computer Entertainment of America, Inc. v. American Home Assurance Co., the insured was sued in a class action suit alleging that the PlayStation 2 home entertainment system “suffered from an ‘inherent’ or ‘fundamental’ design defect that rendered them unable to play DVDs and certain game discs.” 64 The complaint also alleged false advertising. 65 The court found that, as there was no coverage for the underlying claims, a provision excluding false advertising that contained a carve-back provision did not create coverage where none otherwise existed. 66 The court described the relevant analysis as follows: “If coverage exists, then the court considers whether any exclusions apply. If coverage does not exist, the

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62 Id. at 288, 913 N.E.2d at 53.
63 Id. at 294-95, 913 N.E.2d at 58.
64 532 F.3d 1007, 1011 (9th Cir. 2008).
65 Id.
66 Id. at 1017-18.
inquiry ends. The exclusions are no longer part of the analysis because they cannot expand the basic coverage granted in the insuring agreement.67

C. The Underlying Action’s Status As A Class Action Suit Does Not Affect Coverage Issues

The underlying plaintiffs’ status as a class does not impact the analysis of whether the policy covers the claims in the underlying action.68 The Omega Flex court specifically stated, “[W]e do not believe that an insured must demonstrate that the plaintiffs will satisfy rule 23 in order to receive a defense from its insurer. Just as in any other type of action, the insurer’s duty to defend is determined by looking to the face of the complaint.”69 It specifically interpreted that rule to mean that, “[i]n the context of a class action complaint, we understand that principle to mean that we should avoid anticipating the possible outcome of the certification process . . . [because] [t]he fact that some of the claims may ultimately be deemed unsuitable for class treatment should not deprive the insured of the benefit of a defense, provided the complaint fairly can be read to assert one or more claims that fall within the scope of the policy.”70

67 Id. at 1017 (quotation omitted).
69 Id. at 268, 937 N.E.2d at 58.
70 Id.; see also Hartford Acc. & Indem. Co. v. Beaver, 466 F.3d 1289, 1293 (11th Cir. 2006) (“Nothing in Florida law even remotely suggests that the potential for coverage created by a class action is qualitatively different from the potential for coverage created by an individual action. Florida’s courts have uniformly said that a suit alleging facts that fairly and potentially bring the suit within policy coverage triggers an insurer’s duty to defend.”).