If you have questions or would like further information regarding Completed Operations/ Products Exclusions, please contact:

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ILLINOIS LAW MANUAL

CHAPTER XII
<u>EXCLUSIONS TO COVERAGE</u>

C. COMPLETED OPERATIONS/PRODUCTS

Under most comprehensive general liability policies, the insurance does not apply to bodily injury or property damage arising out of the insured's own work or product. This issue is most often address by various exclusions. The "products-completed operations hazard" is generally defined in the Definitions section of the comprehensive general liability policy. A typical policy states:

13. products-completed operations hazard:

    a. includes all bodily injury and property damage arising out of your product or your work except products that are still in your physical possession or work that has not yet been completed or abandoned. The bodily injury or property damage must occur away from premises you own or rent unless your business includes the selling, handling or distribution of your product for consumption on premises you own or rent.

       Your work will be deemed completed at the earliest of the following times:

       (1) when all of the work called for in your contract has been completed;

       (2) when all of the work to be done at the site has been completed if your contract calls for work at more than one site; or

(3) when that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed;

b. does not include bodily injury or property damage arising out of:

(1) the transportation of property unless the injury or damage arises out of a condition in or on a vehicle created by the loading or unloading of it; or

(2) the existence of tools, uninstalled equipment or abandoned or unused materials.

This policy defines "property damage" to include either physical destruction of tangible property or the loss of use of such property which is not physically destroyed. In a typical policy, definitions also defines "impaired property:"

5. 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 the contract or agreements;

   provided the repair, replacement, adjustment or removal of your product or your work or your fulfilling the terms of the contract or agreement can restore the impaired property to use;"

Other definitions may be relevant, depending upon the facts of the specific case.

The insuring agreement of the comprehensive general liability policy generally states that:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury, property damage, personal injury, or advertising injury . . . caused by an occurrence . . . during the policy period.

The occurrence must arise out of the conduct of the insured's business, excluding advertising, publishing, broadcasting, or telecasting done by or for the insured. However, commercial liability policies are not intended to pay the costs associated with the repair or replacement of the insured's own defective work product. Elco Industries v. Liberty Mut. Ins. Co., 90 Ill. App. 3d 1106, 1109-10 (1980); Qualls v. Country Mut. Ins. Co., 123 Ill. App. 3d 831, 834 (1984). To hold otherwise transforms a commercial liability policy into a performance bond. Qualls, 123 Ill. App. 3d at 834.

The standard "business risk" exclusions to the commercial liability policy reinforce the principles that faulty workmanship and the cost of repair and replacement do not constitute property damage under the coverage. The intent of the commercial and general liability policies is to protect the insured from liability for injury to people or property, and not to pay the costs associated with the repair or replacement of the insured's own defective work and products.

Resolution of coverage questions in this area must be addressed on a case-by-case basis because of the high degree of factual specificity required by court decisions and the complexity of the policy provisions. For example, in Elco, 90 Ill. App. 3d at 1109-10, the insured, Elco, was sued for allegedly failing to heat-treat governor regulator pins, one of Elco's own products, intended for installation into its customers' engines. The Elco court found that the repair and replacement of the defective pins, which required the disassembly of finished engines, the destruction of gaskets, and the destruction of plugs, caused damage to components of the finished engines. In other words, the Elco court found that the allegations triggered the duty to defend because

correcting the alleged property damage problem was the "occurrence" which resulted in property damage to finished engines. Id. at 1111.

In Marathon Plastics, Inc. v. International Ins. Co., 161 Ill. App. 3d 452 (1987), the Illinois Appellate Court found coverage under the policy where the insured sold defective gaskets and pipes to a water system installer, even though no physical injury occurred to the water system. Id. at 463. The Marathon Plastics court found that "property damage" "occurred" to the water system because the defective pipes caused the entire water system to become useless and reduced in value. Similarly, in Eljer Mfg., Inc. v. Liberty Mut. Ins. Co., 972 F. 2d 805 (1992), the Seventh Circuit found coverage, although the defective plumbing system had not yet leaked, thereby not yet resulting in physical injury. The Eljer case is probably the most clear-cut example of the court reaching to find coverage to benefit the insured.

In W.E. O'Neil Construction Co. v. National Union Fire Ins. Co., 721 F. Supp. 984 (1989), the court held that property damage occurs when a defective product (steel mesh) installed by the insured is integrated into someone else's property (garage). In this case, the court held that the damage occurs exclusive of the cost of repairing or replacing the defective part, even where the insured is responsible for the construction of the entire structure. W.E. O'Neil Construction Co., 721 F. Supp. at 992. See also Harbor Ins. Co. v. Tishmon Construction Co., 218 Ill. App. 3d 936, 942 (1991).

In Sentry Insurance Company v. S. and L. Home Heating Co., 91 Ill. App. 3d 687 (1980), the court determined that the loss of productivity, profits, and the expense of repairing a deficient heating and ventilation system were economic losses and not property damage. However, the Sentry court did observe that the deterioration and

corrosion in the heat exchangers in air conditioning compressors, which resulted from the deficient H.V.A.C. system, might fall within the definition of "property damage." Id. at 690. This is similar to the result arrived at in U.S. Fidelity & Guaranty Company v. Wilkin Insulation Co., 193 Ill. App. 3d 1087 (1989), which analyzed the terms "property damage" and "occurrence" in finding that property damage was caused by asbestos contamination, thereby triggering the insurance coverage.

In Bituminous Cas. Corp. v. Gust K. Newberg Constr. Co., 218 Ill. App. 3d 956 (1991), the court argued the distinction between a faulty ventilation system which failed in its intended purpose, as contrasted to the policy definition which required property damage due to physical injury or destruction. Under the allegations of the Bituminous Casualty case, the court determined that there was no coverage.

Similarly, in Diamond State Ins. Co. v. Chester-Jensen Co., 243 Ill. App. 3d 471 (1993), the court found no duty to defend in the absence of express allegations of physical injury to property resulting from a defective air conditioning system. Diamond State, 243 Ill. App. 3d at 479. In Diamond State, the court found that neither of the two prongs of the property damage definition were met and that the allegations sought recovery only for economic losses. The court in Diamond State found no express allegations of physical injury to property, but only allegations that the insured's production (thermal units) failed to perform the anticipated function.