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CASENOTE

**PROPERTY DAMAGE IN THE ENVIRONMENTAL CONTEXT:
WHEN CONTAMINATED CARBON DIOXIDE CONTAMINATES CARBONATED DRINKS**

*National Union Fire Ins. Co. of Pittsburgh, P.A. v. Terra Industries, Inc.*¹

I. INTRODUCTION

In 1998, Britvic Soft Drinks and Bacardi-Martini, two British companies that bottle and sell carbonated beverages, issued mass recalls of certain products after discovering that some batches of drinks contained traces of benzene.² While the quantities of benzene did not pose health risks to consumers, public unease and the concern for the companies' reputations led to the recall and destruction of finished drinks.³ The benzene was introduced into the drinks through carbon dioxide—used to carbonate the beverages—because the supplier of the carbon dioxide, Terra Industries, Inc. ("Terra" or "Terra Industries") failed to remove it during the manufacturing process.⁴ Britvic and Bacardi-Martini sued Terra, and the court found Terra liable for the recall.⁵ This case addresses whether Terra's insurer is responsible to indemnify Terra for the damage that the carbon dioxide caused to the drinks.

II. FACTS AND HOLDING

Terra Industries is a manufacturer of fertilizer, nitrogen products, and methanol.⁶ A by-product of Terra's fertilizer production is carbon dioxide, which Terra sells for a variety of uses, including use in carbonated beverages.⁷ Terra Industries purchased a commercial umbrella liability insurance policy from National Union Fire Insurance Company of Pittsburgh, P.A. ("National Union"),⁸ which provided liability coverage in the event that Terra caused property damage or bodily injury to a third party.⁹ The policy defined "property damage" as either "physical injury to tangible property, including all resulting loss of use of that property" or "loss of use of tangible property that is not physically injured."¹⁰

¹ 216 F. Supp. 2d 899 (N.D. Iowa 2002).

² See *infra* n. 13.

³ See *infra* nn. 129 and 13.

⁴ See *infra* nn. 12-13.

⁵ See *infra* n. 20.

⁶ *Id.* at 901. Terra Nitrogen is an indirect wholly-owned subsidiary of Terra Industries (collectively "Terra"). *Id.* Terra Industries's principal place of business is Iowa. *Id.* Terra Nitrogen produces fertilizer in the United Kingdom. *Id.*

⁷ *Id.* at 902.

⁸ *Id.* Terra paid \$3,200,000 for the policy. *Id.* The policy covered Terra Nitrogen as a subsidiary of Terra Industries. *Id.* Terra's primary commercial general liability policy was through CIGNA, and provided for liability incurred up to the amount of \$1,000,000. See *id.* at 903.

⁹ *Id.* The National Union policy provides: "We will pay on behalf of the Insured those sums in excess of the Retained Limit that the Insured becomes legally obligated to pay by reason of liability imposed by law or assumed by the Insured under an Insurance Contract because of Bodily Injury, Property Damage, Personal Injury or Advertising injury that takes place during the Policy Period and is caused by an Occurrence happening anywhere in the world." *Id.*

¹⁰ *Id.* The definition provides, in both clauses, that "all such loss of use shall be deemed to occur at the time of the physical injury (or occurrence) that caused it." *Id.* The policy defines an "occurrence" with respect to property damage as "an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage

In 1998, Terra sold carbon dioxide to several British companies, who in turn resold it to beverage bottling companies for use in carbonated beverages.¹¹ In May of that year, Terra discovered the chemical benzene was present in some of the carbon dioxide.¹² The companies to which Terra had sold the carbon dioxide decided that the benzene's presence caused the beverage products to be unsuitable for human consumption, and thus they recalled all the contaminated beverage products from distributors and retailers.¹³ The companies then asserted claims individually against Terra, seeking to be held harmless from all fees, costs, expenses, and damages associated with any claims resulting from the benzene contamination.¹⁴ Terra proceeded to notify National Union of these claims.¹⁵

The first company's case went to trial in a British court in 2001.¹⁶ While that trial was in progress, National Union agreed to provide coverage for any adverse judgment in that case.¹⁷ The court found that the carbon dioxide was contaminated with benzene, and that therefore the end products—the beverages—were also contaminated.¹⁸ Thus, the court held that the beverages could not be considered suitable for human consumption, and the recall was necessary.¹⁹ The court found Terra liable for breach of express warranty and breach of contract.²⁰ National Union made payment to satisfy the court's judgment.²¹

In the second trial, the parties stipulated that the relevant factual findings of the first trial would be binding.²² However, a significant difference in the second trial was the presence of a liability-limiting contractual provision between the company (Messer UK, Ltd.) that had purchased the carbon dioxide from Terra and the beverage bottling company (Bacardi-Martini) to which it had re-sold the carbon dioxide.²³ (The parties in the first case had not bargained for such a provision, which limited Messer's—and thus Terra's—liability for “direct physical damage to property” to £500,000.)²⁴ Thus, the only issue before the court was whether the plaintiff's claims arose from “direct physical damage to property.”²⁵ The judge found that the

neither expected nor intended from the standpoint of the Insured. All such exposure to substantially the same general conditions shall be considered arising out of one Occurrence.” *Id.* The policy also provided that National Union has “the right and the duty” to provide Terra with a defense against any claim or lawsuit seeking damages against Terra that is covered by the terms of the policy. *Id.*

¹¹ *Id.*

¹² *Id.* at 903. The benzene was not present in amounts large enough to pose a threat to human life. *Id.*

¹³ *See id.* at 904.

¹⁴ *Id.* at 903.

¹⁵ *Id.* Terra's initial defense costs exhausted its \$1,000,000 primary policy with CIGNA. *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *See id.* at 904-905.

¹⁹ *See id.* at 905.

²⁰ *Id.*

²¹ *Id.* at 906. The amount of the judgment against Terra was unclear from the case. *See id.*

²² *Id.*

²³ *See id.* at 905-06.

²⁴ *Id.* at 905. The limitation on liability provision stated: “Subject to any other limitation or exclusion of liability expressed elsewhere in this Contract, the liability of Messer, its employees and Agents to the Customer in respect to personal injury or direct physical damage to property (and losses, costs and expenses directly arising from such injury or damage), whether through negligence or otherwise, shall be limited to £500,000 in respect of any one incident, except that nothing in this Contract shall restrict Messer's liability to any injured person or his personal representatives for personal injury or death resulting from negligence.” *Id.* Terra argued that this contractual limitations provision capped the plaintiff's (Bacardi-Martini) potential recovery at £500,000. *Id.*

²⁵ *Id.* If the court found that the claims did arise from direct physical damage to property, Terra's maximum exposure would be capped. If the court found it did not, then no limitation would apply. *Id.*

claims did not arise as such, and therefore the £500,000 cap did not apply.²⁶ The judge reasoned that the contaminated carbon dioxide could not have physically damaged the beverages, because the beverages as a finished product did not exist until after the carbon dioxide was mixed with the other ingredients.²⁷ The court entered a judgment against Terra in the amount of £3,135,117.47.²⁸ National Union refused to pay on the ground that “the loss suffered was economic in nature” and the coverage Terra purchased extended only to physical loss.²⁹

National Union subsequently sued Terra, seeking a declaratory judgment from the court stating that it was not obligated to indemnify Terra.³⁰ Terra counterclaimed for breach of contract and sought an opposite declaration from the court recognizing National Union’s obligation to indemnify and defend Terra.³¹ The parties both moved for summary judgment.³² The United States District Court for the Northern District of Iowa held that, when carbon dioxide becomes contaminated with benzene and is sold for use in beverages destined for human consumption, this constitutes an “occurrence” within the liability policy, thus resulting in “property damage” when the contaminated carbon dioxide is incorporated into the beverages making them unsuitable for human consumption.³³

III. LEGAL BACKGROUND

Commercial General Liability (“CGL”) insurance protects businesses from liability for bodily injury or property damage to third parties, provided the injury occurs during the policy period.³⁴ In this context, the terms “property damage” and “occur”³⁵ have been the focus of coverage disputes.³⁶ In an attempt to avoid these disputes, insurance companies have occasionally made changes to policy language and definitions.³⁷ Nonetheless, circumstances still exist where meanings are unclear.

²⁶ *Id.*

²⁷ *See id.* at 906-907. The judge contrasted these facts with a situation where the beverage product, after it had become a finished product but before it was bottled, was exposed to dirt because of a defect in the bottles. This would have constituted direct physical damage to the end product. *Id.* at 907.

²⁸ *Id.* at 907.

²⁹ *See id.*

³⁰ *Id.* at 901.

³¹ *Id.*

³² *Id.*

³³ *Id.* at 919.

³⁴ *See* Irene A. Sullivan & Peri Erlanger, *Introduction to the Comprehensive General Liability (CGL) Policy*, 658 PLI/Comm. 7, 11 (May-June 1993). In 1986, the name of the policy changed from “Comprehensive” to “Commercial,” presumably because the prior title could be understood to provide more coverage than the form was intended to deliver. Robert H. Jerry, II, *Understanding Insurance Law* 541 (3d ed., Matthew Bender & Co., Inc. 2002).

³⁵ Usually “occurrence.”

³⁶ *See* Sullivan, *supra* n. 34, at 12.

³⁷ Insurance companies generally do not write their own policies. *See* Timothy Stanton, Student Author, *Now You See It, Now You Don't: Defective Products, the Question of Incorporation and Liability Insurance*, 25 Loy. U. Chi. L.J. 109, 111 (1993). When general liability insurance first gained notoriety in the late nineteenth century, individual insurance companies each wrote their own policies. *Id.* By the 1930s, however, the variance among terms and coverage prompted insurance companies to seek to create more standardized, industry-wide forms. *See id.* at 111-12. Today, industry trade groups draft standard policies jointly, in order to achieve standard terms and conditions throughout the industry. *See Aetna Life & Casualty v. Patrick Industries, Inc.*, 645 N.E.2d 656, 659 (Ind. Ct. App. 1995). Also, revisions are made by an insurance company association, the Insurance Services Office, Inc. (“ISO”). Stanton, 25 Loy. U. Chi. L.J. at 114.

A. "Property Damage"

Prior to 1973, the standard CGL policy defined "property damage" as "injury to or destruction of tangible property."³⁸ In 1973, the ISO redefined it as "*physical* injury to or destruction of tangible property . . ."³⁹ in order to clarify the scope of coverage.⁴⁰ Courts have construed the term "tangible property" to mean property that is "capable of being handled or touched."⁴¹ Therefore, it is evident from the definition that coverage extends to obvious physical injury to property that can be touched.⁴² What is less clear is how the property damage definition applies to situations in which the insured's defective component is incorporated into a larger entity, and causes damage to the larger entity.⁴³

In such a situation, the insured, hoping to trigger liability coverage, generally argues that the incorporation of the defective component into the larger entity constitutes property damage to the larger entity.⁴⁴ Conversely, the insurance company, hoping to avoid coverage, generally argues that the incorporation of a defective component is not property damage, but rather it is only diminution in the value of the larger entity, resulting from the insured's failure to provide the quality of product it promised.⁴⁵ Most courts interpreting the 1973 definition have held that the mere incorporation of a defective component into a larger entity does not result in "physical injury" to the larger entity.⁴⁶

Being, however, that not all courts are in a common accord, some jurisdictions have determined that incorporation of a defective component into a larger entity can result in physical injury.⁴⁷ In fact, upon first

³⁸ Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* 364 (11th Ed., Aspen Law & Business, 2002).

³⁹ *Id.* (emphasis added). The whole post-1973 definition of "property damage" was "(1) the 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 (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.* The second half of the definition provides coverage for property that becomes unusable, but is nevertheless not physically injured. *Id.* at 378.

⁴⁰ See Laurie Vasichek, Student Author, *Liability Coverage for "Damages Because of Property Damage" Under the Comprehensive General Liability Policy*, 68 Minn. L. Rev. 795, 801 (1984).

⁴¹ Ostrager, *supra* n. 38, at 365 (quoting *Lay v. Aetna Ins. Co.*, 599 S.W.2d 684, 686 (Tex. Civ. App. 1980)). This is to be distinguished from, for example, easements, assignments, investments, lost profits, goodwill, copyrights, etc. *Id.*

⁴² See Jerry, *supra* n. 34, at 544.

⁴³ See Robert H. Jerry, II, *Understanding Insurance Law* 442 (2d ed., Matthew Bender & Co., Inc. 1996). When a court is attempting to discern the meaning of an ambiguous term in an insurance policy, the rules of construction are generally the same as those for other contracts. See Sullivan, *supra* n. 34, at 17. The policy language is to be interpreted given its plain and ordinary (not technical) meaning, to achieve a practical and fair interpretation. *Morgan v. Am. Family Mutual Ins. Co.*, 534 N.W.2d 92, 99 (Iowa 1995). The ambiguous terms are to be construed against the insurer, since the insurance contract is one of adhesion. *Id.* However, the mere fact that the parties disagree as to the meaning of a particular term does not make the term ambiguous. *Id.* Finally, a court should not give a strained or unnatural reading to the words to create ambiguity where none exists. *Id.*

⁴⁴ See generally e.g. *Esicorp, Inc. v. Liberty Mut. Ins. Co.*, 266 F.3d 859, 862 (8th Cir. 2001); *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 481, 495 (Ill. 2001); *Kartridg Pak Co. v. Travelers Indem. Co.*, 425 N.W.2d 687, 689 (Iowa App. 1988).

⁴⁵ See generally e.g. *Patrick*, 645 N.E.2d at 658-59; *Kartridg Pak*, 425 N.W.2d at 688; *Esicorp*, 266 F.3d at 862; *Travelers v. Eljer*, 757 N.E.2d at 495.

⁴⁶ See e.g. *Esicorp*, 266 F.3d at 862 (citing *Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d 751, 756 (Minn. 1985) and *Wyo. Sawmills, Inc. v. Trans. Ins. Co.*, 578 P.2d 1253, 1256-57 (Ore. 1978)).

⁴⁷ See e.g. *Geddes & Smith, Inc. v. St. Paul Mercury Indem. Co.*, 334 P.2d 881 (Cal. 1959) (defective doors); *Hauenstein v. Saint Paul Mercury Indem. Co.*, 65 N.W.2d 122 (Minn. 1954) (defective plaster); *Dakota Block Co. v. Western Casualty & Sur. Co.*, 132 S.W.2d 826 (S.D. 1965) (defective concrete block).

glance of applicable case law, one might conclude that such an interpretation was common.⁴⁸ However, most courts following this line of reasoning used the pre-1973 definition of property damage, i.e. “injury to tangible property,” instead of “physical injury to tangible property.”⁴⁹ Under the former definition, it was proper to interpret “property damage” as including diminution in value, because no “physical” injury was required.⁵⁰

Under the post-1973 definition, only a handful of courts have ever interpreted “physical injury” to include diminution in value.⁵¹ The most notable of these courts was the United States Court of Appeals for the Seventh Circuit in *Eljer Manufacturing, Inc. v. Liberty Mutual Ins. Co.*⁵² In this case, Eljer Manufacturing, a plumbing system manufacturer, sought coverage under the post-1973 CGL policy for liability incurred when homeowners sued Eljer, alleging that their plumbing systems were defective and had caused the value of their homes to diminish.⁵³ The Seventh Circuit, noting that it “ha[d] no cases interpreting the 1973 definition,” drew upon tort law, economic theory, and the CGL drafting history of the 1973 revision to conclude that the incorporation of the potentially-defective pipes did constitute property damage.⁵⁴ It held that “physical injury” covers “a loss that results from physical contact, . . . 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 keep the danger from materializing.”⁵⁵

Several courts followed the decision in *Eljer v. Liberty Mutual*.⁵⁶ The California Court of Appeals adopted *Eljer*’s holding in several cases, one involving asbestos contamination,⁵⁷ and another involving splinter-contaminated almonds sold to a cereal maker and incorporated into cereal.⁵⁸ The United States District Court for the District of Kansas also chose to adopt the *Eljer* holding in an asbestos contamination case.⁵⁹

The *Eljer v. Liberty Mutual* holding has been criticized, though.⁶⁰ In *Traveler’s Insurance Company v. Eljer Manufacturing, Inc.*, the Illinois Supreme Court held that the Seventh Circuit failed to interpret the term “physical injury” in its ordinary language sense, violating a “fundamental rule of Illinois law.”⁶¹ The Illinois

⁴⁸ *Supra* n. 47.

⁴⁹ See *Kartridg Pak*, 425 N.W.2d at 690; see also *supra* n. 47 (Each of these cases interpreted “injury to or destruction of property” to include diminution in value of property. *Patrick*, 645 N.E.2d at 659).

⁵⁰ See *Vasichek*, *supra* n. 40, at 809-10. The pre-1973 policy should be interpreted as covering diminution in value. *Id.* If the drafters had intended to require a physical injury, they would presumably have indicated so in their definition. *Id.* at 808. They did not do so, therefore the “injury” in the “property damage” definition must be construed as including both physical and non-physical injury. *Id.* at 810. Diminution in value of tangible property harms that property, and thus constitutes the “injury to or destruction of tangible property” required by the pre-1973 “property damage” definition. *Id.*

⁵¹ See e.g. *University Mechanical Contractors of Arizona, Inc. v. Puritan Ins. Co.*, 723 P.2d 648 (Ariz. 1986); *U.S. Fidelity & Guaranty Co. v. Wilkin Insulation Co.*, 578 N.E.2d 926 (Ill. 1991) (*infra* note 84).

⁵² 972 F.2d 805 (7th Cir. 1992). It is important to bring to the reader’s attention that there are two cases involving the company Eljer Manufacturing, Inc. mentioned in this note: *Travelers v. Eljer* (see *infra* n. 78) and *Eljer v. Liberty Mutual* (this case). Both of these cases involve the insurer’s obligation to indemnify Eljer for manufacturing a plumbing system that was defective, but the respective courts held differently in both cases. See *infra* nn. 54-55 and 78.

⁵³ See *id.* at 807. Some of the homeowner’s plumbing systems had actually leaked, while others had not. *Id.* Liberty Mutual did not contest coverage in cases where the pipes had leaked. See *id.* at 807-08. Where the pipes had not leaked, Liberty Mutual denied coverage on the basis of lack of “physical injury.” See *id.* at 808.

⁵⁴ *Id.* at 812.

⁵⁵ *Id.* at 810.

⁵⁶ See *infra* nn. 57-59.

⁵⁷ *Armstrong World Indus., Inc. v. Aetna Cas. & Surety Co.*, 52 Cal. Rptr. 2d 690 (Cal. Ct. App. 1996). See *infra* n. 84.

⁵⁸ *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 93 Cal. Rptr. 2d 364 (Cal. Ct. App. 2000). See *infra* n. 84.

⁵⁹ *Johnson v. Studyvin*, 828 F. Supp. 877 (D. Kan. 1993). See *infra* note 84.

⁶⁰ See e.g., *Travelers v. Eljer*, 757 N.E.2d at 496-502.

⁶¹ *Id.* at 497.

court further criticized the Seventh Circuit for straining to interpret “sparse” drafting history as suggesting that “the term ‘physical injury’ does not require that the covered property actually be ‘injured’ in a ‘physical’ sense as a result of the [defective pipes], but only that claimants suffered *any* ‘loss that results from physical contact . . .’ with the [defective pipes].”⁶²

B. “Occurrence”

The term “occurrence,” as it is used in standard CGL policies, has also been a source of controversy.⁶³ The CGL policies cover “occurrences,” such that the incident giving rise to potential liability must be an “occurrence” for coverage to exist at all.⁶⁴ The CGL standard form defines “occurrence” as “an accident, including continuous or repeated exposure to conditions, which results in . . . property damage neither expected nor intended from the standpoint of the insured.”⁶⁵ However, the CGL standard form does not define “accident”—a term which has necessarily been defined by the courts.⁶⁶ In *Norwalk Ready Mixed Concrete, Inc. v. Travelers Ins. Co.*, the Eighth Circuit held that when “accident” is used in the definition of “occurrence,” but left undefined in the policy, the ordinary meaning to be given the term is “an undesigned, sudden, and unexpected event, usually of an afflictive or unfortunate character, and often accompanied by a manifestation of force . . . [The term] clearly implies a misfortune with concomitant damage to a victim, and not the negligence which eventually results in that misfortune.”⁶⁷ Courts have also held that, when an insured is unaware of a defect in its product, and that product is incorporated into another product and results in damage, such damage is considered to arise out of an “occurrence.”⁶⁸

IV. INSTANT DECISION

Ultimately, the District Court concluded that “property damage” occurred when contaminated carbon dioxide was used in beverages, and therefore an insurer was liable under a liability policy it issued to the party responsible for the contamination.⁶⁹ Before reaching this conclusion, though, the District Court addressed two preliminary matters. First, it stated its standard for granting summary judgment.⁷⁰ Second, it laid out the relevant Iowa law necessary to determine when the terms of a contract are ambiguous.⁷¹ With this backdrop, the court moved on to the first of two substantial issues before it.

⁶² *Id.* at 497 (quoting *Eljer v. Liberty Mutual*, 972 F.2d at 810). The Illinois Supreme Court stated that, “[h]ad the *Eljer* court applied its own ordinary-meaning interpretation of the phrase ‘physical injury’ to the claims presented, the result would have been the same as our result today: without a ‘harmful change in appearance, shape, composition, or some other physical dimension’ . . . to the claimant’s property, the insurance coverage is not triggered.” *Id.*

⁶³ See Sullivan, *supra* n. 34, at 12.

⁶⁴ Jerry, *supra* n. 34, at 560.

⁶⁵ *Id.* at 546. This definition was incorporated into the standard CGL policy in 1973. It is the definition used in the *Terra* case (see *supra* n. 10). In 1998, the definition was changed again to “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” *Id.*

⁶⁶ See generally *Potomic Ins. of Ill. v. Huang*, 2002 WL 418008 at *6 (D. Kan. March 1, 2002).

⁶⁷ 246 F.3d 1132, 1136-37 (8th Cir. 2001) (quoting *Central Bearings Co. v. Wolverine Ins. Co.* 179 N.W.2d 443, 448 (Iowa 1970)).

⁶⁸ See *Chubb Ins. Co. of N.J. v. Hartford Fire Ins. Co.*, 1999 WL 760206, *4 (S.D.N.Y. Sept. 27, 1999) (failure to supply one-hundred percent pure apple juice concentrate to Coca-Cola Foods); *Aetna Casualty & Surety Co. v. General Time Corp.*, 704 F.2d 80, 83 (2d Cir. 1983) (electric motors malfunctioned after being incorporated into third party’s product).

⁶⁹ See *Terra*, 216 F. Supp. 2d at 919.

⁷⁰ *Id.* at 908. The court did not consider the standards in any detail, but merely provided Fed. R. Civ. P. 56. *Id.*

⁷¹ *Id.* at 909-11. See *supra* n. 43.

This first substantial issue before the court was whether “property damage” had occurred when the carbon dioxide contaminated with benzene rendered beverages unsuitable for human consumption.⁷² Not finding an Iowa case directly on point,⁷³ the District Court turned to other jurisdictions for an answer.⁷⁴ It addressed seven analogous cases: three involving injuries that did not amount to property damage, and four involving injuries that did.⁷⁵

Of the three cases that did not amount to property damage, the first case involved an insurer’s obligation to indemnify a company’s liability when tests that the company had run failed to disclose defective welding on pipes.⁷⁶ The District Court distinguished that case from the case before it on the grounds that the pipes could be individually repaired, and had not damaged the entire building, whereas the contaminated carbon dioxide had ruined all of the beverages it was incorporated into.⁷⁷ The second case involved an insurer’s obligation to indemnify a company’s liability for manufacturing a plumbing system that was defective but had not yet caused damage.⁷⁸ The District Court again distinguished that case, noting that the contaminated carbon dioxide had in fact already caused damage to the beverages.⁷⁹ The third case involved an insurer’s obligation to indemnify a company’s liability for installing vinyl covering on particle board in camper trailers, when the covering later peeled off.⁸⁰ Again, the District Court distinguished the case, because unlike the contaminated beverages, the trailers could be repaired.⁸¹

After distinguishing those three cases, the District Court directed its attention to four cases involving injuries that did constitute property damage. The first case addressed an insurer’s obligation to indemnify a company’s liability when the company sold almonds containing wood splinters to a cereal-maker that included the tainted almonds in cereal.⁸² The court in that case held that property damage occurs when a product containing potentially dangerous material is included into another product and causes loss because of the

⁷² *Terra*, 216 F. Supp. 2d at 911.

⁷³ *See id.* at 913. The District Court did fully analyze the Iowa case of *Kartridg Pak*, 425 N.W.2d 687. *Id.* at 911-13. That case, addressing the same issue as the case at bar, involved the manufacturer of a machine that removed bone particles from processed meat. *Id.* at 912. The general liability policy’s definition of “property damage” was nearly identical to the one used by National Union (see n. 10). *Id.* The machine did not properly separate the meat and bone, rendering the meat unsuitable for human consumption, so the meat processing company sued the manufacturer. *Id.* The court held that the insurer was not obligated to indemnify the manufacturer because the damage was only diminution of the value of the meat and not physical “property damage.” *Id.* The District Court distinguished this case because the contaminated product, the meat, was not incorporated into another product, as was the carbon dioxide in the case at bar. *Id.* at 913.

⁷⁴ *Id.* at 913.

⁷⁵ *See infra* nn. 76-84.

⁷⁶ *See id.* at 914. The case was *Esicorp*, 266 F.3d 859, and involved a definition of “property damage” identical to the National Union policy (see *supra* n. 10). *Id.* The court in that case held that this did not amount to property damage because “property damage” required some real physical injury to tangible property, and the mere need to repair some welding did not amount to physical injury. *Id.*

⁷⁷ *Id.*

⁷⁸ *See id.* at 914-15. The case was *Travelers v. Eljer*, 757 N.E.2d 481, in which the court held that “property damage” requires “physical injury to tangible property,” which suggests damage causing an alteration in appearance, shape, color, or some other material dimension. *Id.* Because the plumbing system had not caused any damage that met the court’s definition, the court held that property damage had not occurred. *Id.* at 915.

⁷⁹ *Id.* at 915.

⁸⁰ *See id.* at 915-16. The case was *Patrick*, 645 N.E.2d 656. *Id.* at 915. Interpreting a definition of “property damage” identical to the case at bar (see *supra* n. 10), the court held that, because the word “physical” was placed before the word “injury,” the coverage was for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the completed product is not that for which the damaged party bargained. *See id.*

⁸¹ *Id.* at 915-16.

⁸² *See id.* at 916. The case was *Shade Foods*, 93 Cal. Rptr. 2d 364.

presence of the potentially dangerous material.⁸³ Without distinguishing the case from the case at bar, the District Court proceeded to examine the final three cases, all concerning insurers' obligations to indemnify for third party loss involving asbestos contamination.⁸⁴ The respective courts in each case held generally that, when asbestos is physically touching a building, the asbestos fiber contamination amounts to physical injury to the building, and thus property damage.⁸⁵

Based on its analysis of the decisions from other jurisdictions, the District Court concluded that the beverages had suffered property damage from the inclusion of a potentially dangerous substance—the contaminated carbon dioxide.⁸⁶ This caused loss because the presence of benzene rendered the beverages useless for their intended purpose, human consumption, since the beverages could not be restored to an uncontaminated state.⁸⁷ The District Court held the damage in this case met the definition of property damage: “damage to tangible property causing an alteration in appearance, shape, color or in other material dimension.”⁸⁸

The second substantial issue before the court was whether the property damage was caused by an “occurrence,” a prerequisite for recovery under the insurance policy.⁸⁹ The policy defined an occurrence as “an accident...which results in...Property Damage neither expected nor intended from the standpoint of the Insured.”⁹⁰ The District Court noted that other courts have held that, where an insured unintentionally sells a defective product that is incorporated into a third-party's finished product, the resulting impairment to the third party's product is an “occurrence.”⁹¹ The court applied that rule, holding the property damage in this case was caused by an “occurrence.”⁹²

Because the carbon dioxide contaminated with benzene being sold for incorporation into beverages constituted an “occurrence” within the liability policy, and because this occurrence resulted in “property

⁸³ See *id.*

⁸⁴ See *id.* at 916-17. The first case was *Armstrong*, 52 Cal. Rptr. 2d 690, in which the court held that property damage occurred when the presence of asbestos causes injury to a building “because the potentially hazardous material is physically touching and linked with the building and . . . the injury is physical even without a release of toxic substances into the building's air supply.” *Id.* at 916. The next case was *Johnson*, 828 F. Supp. 877, in which an installer sprayed an asbestos-containing textured ceiling in a house. *Id.* In holding that this constituted property damage, the court held that at the moment when a defective product is attached to some property in a manner that makes it not easily removed, that property is physically injured. *Id.* The final case was *Wilkin*, 578 N.E.2d 926, in which the Illinois Supreme Court held that asbestos fiber contamination constitutes physical injury to tangible property due to its “continuous release” of toxins. *Id.* at 917.

⁸⁵ See *supra* n. 84.

⁸⁶ See *id.* at 917-18. (“[L]ike the wood laced nut clusters in *Shade Foods*, and the asbestos intertwined building products in *Armstrong*, *Johnson*, and *Wilkin*, the court concludes that the beverages were damaged by the introduction of potentially injurious material, the carbon dioxide containing a known carcinogen.” *Id.*)

⁸⁷ See *id.* at 917.

⁸⁸ *Id.* at 917. To reach this definition of property damage, the District Court noted that the National Union policy defined “property damage” as “physical injury to tangible property, including all resulting loss of use of that property,” but that the policy did not define the phrase “physical injury to tangible property.” *Id.* Nevertheless, the court found the phrase unambiguous, and concluded that the Iowa Supreme Court would adopt the definition expressed by the Illinois Supreme Court in *Travelers v. Eljer* (see *supra* n. 78). *Id.*

⁸⁹ See *id.* at 918.

⁹⁰ *Id.*; see also *supra* n. 10.

⁹¹ *Id.*

⁹² See *id.* The court briefly mentioned two analogous cases “presenting virtually indistinguishable facts,” *Chubb Ins. Co.*, 1999 WL 760206 and *General Time*, 704 F.2d 80. *Id.* at 918-19.

damage,” the District Court held that the injury was one covered under the commercial liability policy, and National Union was obligated to indemnify Terra.⁹³

V. COMMENT

The *Terra* case is important because the court interprets the CGL term “property damage” in the context of contamination to property caused by a natural environmental pollutant. Before *Terra*, most courts that interpreted “property damage” did so in the context of structural damage caused by a defective part or dangerous component.⁹⁴ Therefore, the *Terra* court had to draw analogies between defective parts, dangerous components, and natural environmental pollutants. In some areas, the analogies were easier to draw than in others. The District Court was not able to reach its result seamlessly, but an analysis of the rationale behind its decision should lead the reader to conclude that the court was correct, and therefore insurance companies that insure products susceptible to this kind of natural environmental contamination should take notice of the reasons underlying the court’s determination.

The reasoning of the District Court was strengthened by the fact that it expressly noted and rejected the holding of *Eljer v. Liberty Mutual*.⁹⁵ However, it based its reasoning on three cases that adopted the *Eljer v. Liberty Mutual* rule.⁹⁶ Therefore, *Eljer v. Liberty Mutual* deserves some discussion.

The United States Court of Appeals, Seventh Circuit, decided *Eljer v. Liberty Mutual* in 1992.⁹⁷ In holding that “property damage” occurred when a defective plumbing system was installed and had to be removed, the Seventh Circuit explicitly rejected an “ordinary-language” interpretation of the phrase “physical injury.”⁹⁸ Instead, the court determined that “*physical injury*” was distinguishable from “physical *injury*.”⁹⁹ “*Physical injury*,” which the court defined as “an injury that causes harmful physical alteration in the thing used,” was not necessary for coverage.¹⁰⁰ Rather it was only necessary to have “physical *injury*,” which it defined as “a loss that results from physical contact, . . . 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.”¹⁰¹

Given that ISO changed the definition of “property damage” from “injury to or destruction of tangible property” to “physical injury to or destruction of tangible property” in 1973,¹⁰² one would think that the ISO intended to emphasize the “physical” aspect of the injury, instead of merely focusing on the fact that an injury had occurred. The Illinois Supreme Court agreed, criticizing the Seventh Circuit for failing to interpret the

⁹³ See *id.* at 919.

⁹⁴ See e.g. *Esicorp*, 266 F.3d 859 (defective pipe welding in building); *Johnson*, 828 F. Supp. 877 (asbestos in building); *Armstrong*, 52 Cal. Rptr. 2d 690 (asbestos in building); *Travelers v. Eljer*, 757 N.E.2d 481 (plumbing system); *Wilkin*, 578 N.E.2d 926 (asbestos in building); *Patrick*, 645 N.E.2d 656 (particleboard installed in camper trailers).

⁹⁵ See *Terra*, 216 F. Supp. 2d at 915.

⁹⁶ Its reasoning was based on the *Shade Foods*, *Armstrong*, and *Johnson* decisions. *Id.* at 916-17. All discussed *Eljer v. Liberty Mutual*. See *Shade Foods*, 93 Cal. Rptr. 2d at 377; *Armstrong*, 52 Cal. Rptr. 2d at 733; *Johnson*, 828 F. Supp. at 883. *Wilkin* did not discuss the case because it was decided one year before *Eljer v. Liberty Mutual*, and is itself discussed in *Eljer v. Liberty Mutual*. See *Eljer v. Liberty Mutual*, 972 F.2d at 812-13. *Travelers v. Eljer*, which the court discusses and refuses to follow, is the Illinois Supreme Court case that rejects *Eljer v. Liberty Mutual* as it applied Illinois law. See *Travelers v. Eljer*, 757 N.E.2d at 497.

⁹⁷ 972 F.2d at 805.

⁹⁸ *Id.* at 814, 809-10.

⁹⁹ *Id.* at 810 (emphases in original).

¹⁰⁰ *Id.* (emphasis in original).

¹⁰¹ *Id.* at 810-12 (emphasis in original).

¹⁰² Vasichek, *supra* n. 40, at 806.

policy language in its “plain, ordinary, and popular sense”¹⁰³ and instead substituting an “admittedly ‘conjectured’ analysis” of the phrase.¹⁰⁴ Most states have some case law requiring a plain meaning interpretation of unambiguous language.¹⁰⁵ Therefore, in order to find “property damage” where injury results only from physical contact, and not from some actual physical alteration, a court would either have to find the phrase “physical injury to tangible property” to be ambiguous, or it would have to violate the requirement of plain meaning interpretation. Injury resulting from something other than physical alteration, while it is still an injury, is an economic injury, and falls outside the purview of the CGL.

The District Court relied heavily on cases involving asbestos contamination of buildings.¹⁰⁶ In *Armstrong*, the insureds argued that “physical injury” constituted “loss that resulted from physical contact,”¹⁰⁷ or what *Eljer v. Liberty Mutual* characterized as “physical injury.” The *Armstrong* Court agreed, holding that “diminished market value or abatement costs, or costs of inspecting, assessing, and maintaining the in-place asbestos are not the ‘property damage.’”¹⁰⁸ Rather, the court held that these constituted “the alternative measures of the physical injury to the building. The fact that the measure of damages is economic does not preclude a physical injury.”¹⁰⁹ Such a reading, however, interprets “physical contact” to be the same as “physical alteration”¹¹⁰ just as *Eljer v. Liberty Mutual* does. Under a plain meaning reading, though, inspection costs, assessment costs, and maintenance costs are not the results of a past physical alteration because the asbestos merely coming into contact with the walls does not physically alter the walls.¹¹¹ Rather, they are responses to evaluate and mitigate the extent of the diminution in the building’s value. The fact that they are measured in economic or monetary terms is irrelevant.

The *Johnson* court also held that asbestos contamination constitutes property damage.¹¹² It adopted, with only scant discussion, the rule of *Eljer v. Liberty Mutual*.¹¹³ It is arguable that the District Court should not have even addressed *Johnson*, which cited *Eljer v. Liberty Mutual* for its holding on the point in time when the injury occurs, not *whether*, physical injury occurs.

¹⁰³ *Travelers v. Eljer*, 757 N.E.2d at 497. In *Eljer v. Liberty Mutual*, the Seventh Circuit had interpreted the policy provision employing Illinois law. *Id.* at 496. In *Travelers v. Eljer*, the Illinois Supreme court stated, “[I]t is a well-settled precept of Illinois law that, . . . where a policy provision is clear and unambiguous, its language must be taken in its plain, ordinary, and popular sense.” *Id.* at 497. The Illinois Supreme Court found no ambiguity in the phrase “physical injury to tangible property.” *Id.* at 496.

¹⁰⁴ *Id.* at 497.

¹⁰⁵ See generally Mark K. Suri, Student Author, *Taking the Insurers to the Dumps: Interpreting ‘Damages’—Is There Coverage for Hazardous Waste Cleanup Costs Under Comprehensive General Liability Insurance*, 13 J. Corp. L. 1101, 1121 (1988).

¹⁰⁶ See *Terra*, 216 F. Supp. 2d at 916-17. *Armstrong*, *Johnson*, and *Wilkin* all involved asbestos contamination. *Id.*

¹⁰⁷ See *Armstrong*, 52 Cal. Rptr. 2d at 733 (quoting *Eljer v. Liberty Mutual*, 972 F.2d at 810).

¹⁰⁸ *Id.* at 734.

¹⁰⁹ *Id.*

¹¹⁰ It is not argued that the California Court of Appeals decided *Armstrong* incorrectly. Rather, it is argued that the court was not thorough enough in its holding. *Armstrong* involves asbestos contamination, which constitutes property damage because of the unique toxic nature of asbestos, which emits fibers into the air causing humans to breathe them in. *Armstrong* does not point this out, but rather it perfunctorily adopts the rule from *Eljer v. Liberty Mutual*, a case dealing with defective plumbing systems, not toxic products. *Armstrong* was ultimately correct, but would arguably have been better reasoned if the court had relied on *Wilkin* instead of *Eljer v. Liberty Mutual*.

¹¹¹ See generally *Travelers v. Eljer*, 757 N.E.2d at 500. This analysis would be different if the court had reasoned through the unique toxic nature of asbestos. See *supra* n. 110.

¹¹² *Johnson*, 828 F. Supp. at 883.

¹¹³ *Id.* The language that the *Johnson* court adopted from *Eljer v. Liberty Mutual* was: “[I]ncorporation of a defective product into another product inflicts physical injury in the relevant sense on the latter at the moment of incorporation.” *Id.*

The *Wilkin* case was decided before *Eljer v. Liberty Mutual*, and thus it is the only case that reasons without reference to *Eljer v. Liberty Mutual* that asbestos contamination causes property damage to a building.¹¹⁴ The *Wilkin* case makes an important point that the other asbestos cases leave out: it is the “toxic” nature of asbestos and its potentially deadly effect on humans, rather than mere physical contact with the buildings alone, which causes the property damage.¹¹⁵ Following this reasoning, as opposed to the reasoning of *Eljer v. Liberty Mutual* or *Armstrong*, injury to asbestos-contaminated structures is more than economic. It moves into the realm of “physical alteration” because, although its appearance, shape, and color are unaltered, the asbestos’s presence in the building has changed the structure into a harmful entity, posing a real and present threat to its occupants who might inhale the asbestos fibers.

The *Shade Foods* case involved food contamination rather than asbestos contamination.¹¹⁶ Because its facts are similar to those in *Terra*, it appears the reasoning should be followed. However, while the court’s ultimate decision was probably correct, it disregarded “a line of decisions” interpreting the post-1973 definition of “property damage” (which contained language identical to that which it was interpreting) in favor of a case from 1959, which obviously did not require “physical” injury.¹¹⁷ Second, the court incorporated the rule from *Eljer v. Liberty Mutual* that “property damage” should include “loss that results from physical contact” (“physical injury”).¹¹⁸ Thus, by adopting the reasoning of *Shade Foods*, the *Terra* Court ended up adopting the rule from *Eljer v. Liberty Mutual*, a case that it had expressly noted and rejected earlier in the opinion.

Even given the adoption of the *Shade Foods* reasoning, though, it is easy to conclude that the district court decided *Terra* correctly. The cases that the *Terra* Court adopted used two basic tests, and under both these tests, property damage occurred under the facts in *Terra*.¹¹⁹ The *Travelers v. Eljer* test is met when one entity is incorporated into another and causes “an alteration in appearance, shape, color, or in other material dimension” to the second entity.¹²⁰ This is to be distinguished from mere physical contact, as when one entity is incorporated into another and, though it has not caused the above-mentioned changes, it must be removed at some cost to the owner.¹²¹ The *Wilkin* test is met when one entity’s incorporation into another entity causes the second entity to “pose[] a serious health hazard” to any potential user.¹²²

Terra meets the *Travelers v. Eljer* test because, although the appearance, shape, and color of the carbonated beverages remain unchanged, the unwanted presence of a carcinogen has materially altered the carbonated beverages. The benzene cannot be removed from the carbonated beverages, making this more than mere physical contact.

¹¹⁴ See *Wilkin*, 578 N.E.2d at 931.

¹¹⁵ See *id.* In *Travelers v. Eljer*, the Illinois Supreme Court said, “Our decision in *Wilkin* recognized the unique nature of asbestos products, which disseminate toxic fibers upon installation and continuously contaminate a structure and its contents subsequent to installation.” 757 N.E.2d at 498. It went further to note that “*Wilkin* was premised upon the specific facts before the court in that case and not upon a general proposition that incorporation of a defective component into another structure constitutes ‘physical injury.’” *Id.*

¹¹⁶ *Shade Foods*, 93 Cal. Rptr. 2d at 373-74.

¹¹⁷ See *id.* at 376.

¹¹⁸ *Id.*

¹¹⁹ The *Travelers v. Eljer* test is a test for physical alteration. 757 N.E.2d at 497 (“[W]ithout a ‘harmful change in appearance, shape, composition, or some other physical dimension’ to the claimants’ property, the insurance coverage is not triggered.”). The *Wilkin* test is a test for toxicity. 578 N.E.2d at 931-32 (“It would be incongruous to argue there is no damage to [] property when a harmful element [specifically, toxic asbestos fibers] exists throughout a building . . .”).

¹²⁰ See *Travelers v. Eljer*, 757 N.E.2d at 497.

¹²¹ See *Eljer v. Liberty Mutual*, 972 F.2d at 810-11.

¹²² See *Wilkin*, 578 N.E.2d at 931. The *Wilkin* test is basically the fourth prong of the *Travelers v. Eljer* test, though the fourth prong of physical alteration does not always have to involve a toxic substance to be satisfied.

Terra arguably also meets the *Wilkin* test. Drinking carbonated beverages contaminated with benzene does not pose a serious threat to human life, but if enough is ingested, it can cause leukemia in some humans.¹²³ While insurers can argue that the threat of actually suffering injury from drinking benzene-contaminated carbonated beverages is actually miniscule,¹²⁴ the fact remains that benzene is a genotoxic carcinogen,¹²⁵ and scientists warn that “it is desirable to reduce exposure from all sources, including food and drink.”¹²⁶ Therefore, because of the potential danger associated with consuming benzene, its incorporation constitutes property damage.

VI. CONCLUSION

The lesson for insurers is this: when confronting potential property damage caused by a natural environmental pollutant, determine whether the environmental pollutant has affected the product such that it could be considered an alteration in the product’s appearance, shape, color, or in other material dimension.¹²⁷ If the environmental pollutant has damaged the tangible property’s material substance, then the insurer will probably have to extend coverage.¹²⁸ If the change can be undone, then it probably is not property damage.¹²⁹ Many environmental contamination cases, like the one here, will involve one element contaminating another, which cannot be undone without sophisticated scientific equipment.

Where the change cannot be undone, courts are likely to find property damage where the environmental contaminate is harmful to human life. Benzene is a carcinogen,¹³⁰ thus the court found it was harmful enough to constitute property damage. The threshold seems to lie at whether the contaminant is harmful enough to render the product unusable for any purpose. If so, it constitutes property damage.¹³¹ However, if there is another purpose for which the producer can sell the contaminated product, then it might constitute diminution in value instead of property damage.¹³²

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¹²³ United Kingdom Ministry of Agriculture, Fisheries, and Food, *Carbonated Drinks: Benzene*, 98 Food Safety Info. Bull. (July 5, 1998) <<http://archive.food.gov.uk/maff/archive/food/bulletin/1998/no98/benzene.htm>> (last updated July 5, 1998).

¹²⁴ “The average exposure to benzene from food is much less than the exposure to benzene from active smoking of tobacco or from breathing urban air. [T]he level of exposure from urban air is equivalent to drinking about 40 liters per day of carbonated drinks contaminated with benzene.” *Id.*

¹²⁵ *Id.* A “genotoxic chemical” is one that damages cellular DNA, resulting in mutations or cancer. *The American Heritage Dictionary of the English Language* 734 (Joseph P. Pickett ed., 4th ed., Houghton Mifflin 2000).

¹²⁶ United Kingdom Ministry of Agriculture, Fisheries, and Food, *supra* n. 123.

¹²⁷ See *Travelers v. Eljer*, 757 N.E.2d at 497.

¹²⁸ See *Vasichuk*, *supra* n. 40, at 803-04.

¹²⁹ See *Patrick*, 645 N.E.2d 661-62 (paint-peeled particleboard not property damage because it could be removed from camper trailer and fixed).

¹³⁰ See Ministry of Agriculture, Fisheries, and Food, *supra* n. 123.

¹³¹ See *Ostrager & Newman*, *supra* n. 38, at 380.

¹³² See *id.*