Construction Defect Coverage: Another Court Gets It Wrong

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Viking Construction Co. v. Liberty Mut. Ins. Co., 358 Ill. App. 3d 34 (1st Dist. May 24, 2005), is the most recent case in a string of Illinois Appellate Court construction defect coverage cases to get the analysis wrong. Viking Construction, like its predecessors[1], pays only lip service to settled principles of insurance policy construction, ignores Illinois Supreme Court precedent on the meaning of "accident" and "occurrence," and creates a special framework for construction defect coverage claims.

The pertinent facts in Viking Construction were as follows. Woodland Community School District ("Woodland") contracted with Viking to provide construction management services with respect to the construction of a new middle school. Among other things, Viking was responsible for determining whether construction was proceeding in accordance with contract documents, guarding Woodland against defects and deficiencies in the work, reporting to Woodland if it observed activities or situations that were unsafe, and observing the quality of work.

The general contractor for the construction of the school was Frederick Quinn. Quinn hired Crouch-Walker as the masonry subcontractor, and Crouch-Walker was required to obtain insurance naming Viking as an additional insured. Crouch-Walker obtained a CGL policy and an excess policy from Liberty Mutual, and Viking was named as an additional insured under both.

During the course of construction, portions of a masonry wall collapsed due to inadequate temporary bracing, installed by Crouch-Walker, causing property damage and injuring Anita Kratz, one of the construction workers. Kratz filed a bodily injury suit against Woodland, Viking, Quinn, and Crouch-Walker. Separately, Woodland filed a breach of contract suit against Viking claiming damages for the repair and replacement of damaged property as a result of the wall collapse. Woodland alleged that Viking breached the contract management services contract by failing to warn of the improper bracing of the wall.

Viking tendered its defense in both cases to Liberty Mutual. Liberty Mutual accepted Viking's defense in the Kratz bodily injury case and eventually settled that case for Viking and Crouch-Walker. Liberty Mutual refused to accept Viking's defense in Woodland's breach of contract-property damage case, and eventually Viking settled the Woodland case for $600,000.

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[1] *E.g.*, State Farm Fire and Cas. Co. v. Tillerson, 334 Ill. App. 3d 404 (5th Dist. 2002), Monticello Ins. Co. v. Wil-Freds Construction, Inc., 277 Ill. App. 3d 697 (2nd Dist. 1996), Indiana Ins. Co. v. Hydra Corp., 245 Ill. App. 3d 926 (2nd Dist. 1993).

Viking then sued Liberty Mutual for failing to defend and provide coverage for the settlement of the Woodland case. The trial court entered summary judgment in favor of Viking, and Liberty Mutual appealed. The Illinois Appellate Court, First District, reversed, finding that Liberty Mutual had no duty to defend or provide coverage for the Woodland case. Specifically, the court held that (1) the "general coverage provision" of the CGL policy did not include coverage for breach of contract claims, (2) the collapse of the masonry wall was not an "occurrence" in the Woodland case (although it was in the Kratz case), and (3) despite the wall collapse, there was no "property damage." Having found three reasons to reverse (each erroneous in the author's view), the court found that it need not address the other issues raised by the parties.[2]

"General Coverage Provision"

The court, in its Statement of Facts, stated that the policy contained a "general coverage provision" which it quoted as follows:

> SECTION I – COVERAGES
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> * * *
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> 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.
>
> > * * *
> >
> > (2) Our right and duty to defend end when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverage A or B or medical expenses under Coverage C.

The court continued its summary of the policy by stating that "[t]he policy applied to 'property damage' only if it was "caused by an 'occurrence.'"

Later, in discussing this "general coverage provision," the court stated that it was the "same" as those in the policies at issue in Indiana Ins. Co. v. Hydra Corp., 245 Ill. App. 3d 926 (2nd Dist. 1993), and Aetna Cas. and Surety Co. v. Spancrete, 726 F. Supp. 204 (N.D. Ill. 1989). The court stated that the "general coverage provision" in the Hydra case

[2] The end result in Viking Construction, *i.e.*, no-coverage, might well have been the correct one (for the wrong reasons) due to construction-specific policy exclusions common to most CGL policies, issues as to the breadth of coverage for additional insureds, and an issue in this case as to the possible exhaustion of, apparently, a sub-limit on the coverage. Unfortunately, the Viking Construction court provided only a very short summary of the policy.

provided, "The company will pay on behalf of the insured all sums which the insured shall become legally obligates [sic] to pay as damages because of * * * property damages [sic] to which this insurance applies, caused by an occurrence."

Turning to the Woodland complaint, the court Viking Construction found that it was based entirely on breach of contract. Following the Hydra and Spancrete cases, *supra*, the court held, without any analysis of its own, that the general coverage provision of the CGL policy did not cover the Woodland breach of contract claim:

> Since the general coverage provision of the CGL policy here is the same as in Hydra Corp. and Spancrete, and we see no reason to depart from those courts' rulings, we conclude that the trial court erred in granting summary judgment in favor of Viking against Liberty Mutual because the general coverage provision of the CGL policy does not cover an underlying claim, like Woodland's, for breach of contract.

358 Ill. App. 3d at 45. The author respectfully submits that Viking, Hydra, and Spancrete got it wrong on the issue of the "general coverage provision" and breach of contract claims, especially breach of contract claims arising out of construction defects.

First, there is nothing in the language of the "general coverage provision" of the Liberty Mutual policy quoted in Viking Construction nor in the provision quoted from Hydra that excludes (or even mentions) breach of contract claims. Such limiting language simply does not exist. The "general coverage provision" does include the terms "occurrence" and "property damage," but these terms will be examined in their own right. It would be duplicitous to say that the "general coverage provision" itself precludes coverage for breach of contract claims if it is only the meaning of "occurrence" or another subsidiary term which precludes their coverage. There may also be exclusions or other provisions elsewhere in the insurance policy which preclude coverage for breach of contract claims, or construction defect claims in particular, but the preclusion of coverage for such claims is not a function of the "general coverage provision." To contend otherwise is an unprincipled collapse of the analysis of the policy.

Second, despite Viking Construction and its ilk, Illinois law holds that an insurer has a duty to defend if the allegations against the insured present the potential for coverage regardless of the form or theory of liability of the complaint – even if the theory is breach of contract. In The Travelers Ins. Cos. v. P.C. Quote, Inc., 211 Ill. App. 3d 719, 729 (1st Dist. 1991), the court stated:

> It is not the form of the pleadings but it is the nature of the insured's conduct which determines coverage. The factual allegations of the complaint rather than the legal theory under which the action is brought will determine whether there is a duty to defend. * * * The mere fact that the complaint is presented as a breach of contract action does not protect Travelers from liability, for the court must look to the conduct alleged in

> the language of the complaint to consider potential liability under an insurance policy. [citations omitted]

See also Management Support Associates v. Union Indemnity Ins. Co., 129 Ill. App. 3d 1089, 1097 (1st Dist. 1984) ("Thus, the proper focus for this court is on the allegations and whether they describe MSA's conduct such that it is potentially within the policy's coverage and not on the fact that the complaint sounds in contract"); Lyons v. State Farm Fire and Cas. Co., 349 Ill. App. 3d 404, 407 (5th Dist. 2004) ("The factual allegations of the complaint, rather than the legal theories, determine a duty to defend").

Third, many CGL policies include coverage for the "products-completed operations hazard" which is often defined in a way to include property damage arising out of "warranties or representations made at any time with respect to the fitness, quality, performance or use of 'your work'"[3] – breach of contract! Twenty years ago, in the Illinois Supreme Court's only construction defect insurance decision, the court found that a completed operations breach of warranty claim fell within the CGL policy's insuring clause but went on to consider the policy's exclusions and held that the property damage was excluded from coverage in that case. Western Casualty & Surety Co. v. Brochu, 105 Ill.2d 486 (1985)

Thus, the holding in Viking Construction that the "general insuring provision" of a CGL policy precludes coverage for breach of contract claims is sorely misguided.

"Occurrence"

Following Monticello Ins. Co. v. Wil-Freds Construction, Inc., 277 Ill. App. 3d 697 (2nd Dist. 1996), and Indiana Ins. Co. v. Hydra Corp., 245 Ill. App. 3d 926 (2nd Dist. 1993), the court in Viking Construction held that, where the damages are the "natural and ordinary consequences of defective workmanship," there is no "occurrence." 358 Ill. App. 3d at 54. Again, the court got it wrong.

The "natural and ordinary consequences" test goes too far. By analogy, driving an automobile too fast could never result in an "accident" or "occurrence" causing bodily injury. Yet, insurance coverage is provided every day for injuries arising from negligently speeding and even knowingly speeding, so long as the driver did not intend or expect the injury. Moreover, the injured person has to prove that the speeding was the proximate cause of his injury, which means "a cause which, in natural or probable sequence, produced the injury complained of." Illinois Pattern Jury Instruction (Civil) No. 15.01. "Natural and ordinary consequences" are words of proximate cause. By re-defining "occurrence" to exclude coverage for injury or damage that is the "natural and ordinary consequence" of the insured's workmanship, the court is eliminating coverage for any injury or damage that is proximately caused by the insured's workmanship.

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[3] *See*, *e.g.*, ISO form CG 00 01 07 98 and its definitions of "Products-completed operations hazard" and "Your work."

Manifestly, that cannot be the test for an "occurrence." If it were, the policy's coverage would be illusory.

In apparent recognition that its "occurrence" test was unsatisfactory, the Viking Construction court was compelled to explain how the collapse of the masonry wall could be an "occurrence" for purposes of Kratz's bodily injury suit but not for Woodland's breach of contract property damage suit. The explanation? "Clearly, the causes of action are different." 358 Ill. App. 3d at 46, n. 4. The court went on to explain that the difference was that Kratz was complaining of injury or damage to something other than the defective construction work itself, *i.e.*, her body. Likewise, if Woodland had complained that the collapse of the masonry wall damaged some other property, such other damage could be an "occurrence" as to that property. 358 Ill. App. 3d at 53-54.

If the collapse of, and damage to, a masonry wall is the natural and ordinary consequence of inadequate bracing, would not the resulting damage to a vehicle known to be parked at the foot of that collapsing wall also be the natural and ordinary consequence of the same inadequate bracing? Yet, Viking Construction and the cases on which it relies would say that there has been an "occurrence" with respect to the damaged vehicle and allow coverage for its damage but not for the cost of repairing the wall. In certain circumstances, this might be the right result under the CGL policy if all of its provisions are examined, but there is no basis for this result within the definition of "occurrence."

Finally, in addition to being illogical and not supported by the policy language, the Viking Construction approach to the "occurrence" issue is contrary to Illinois Supreme Court and Appellate Court precedent concerning the meaning of "occurrence" and "accident" in insurance policies. The "occurrence" or "accident" test should turn on whether the injury or damage was expected or intended by the insured, not on a proximate cause test or on the scope of the injury or damage.

Nearly ninety years ago the Illinois Supreme Court held, with respect to the meaning of "accident" in an insurance policy, that "[i]f in the act which precedes the injury, though an intentional act, something unforeseen, unexpected and unusual occurs which produces the injury, it is accidentally caused." Higgins v. Midland Cas. Co., 281 Ill. 431, 437 (1917). In Higgins, the Illinois Supreme Court reversed the appellate court which had affirmed a directed verdict for the insurance company on whether the plaintiff's sunstroke was caused by "accidental" means. The insurance company had contended that the plaintiff's sunstroke was the natural and probable consequence of the plaintiff's activities as a policeman directing traffic on a very warm day. To this the court responded (281 Ill. at 439):

> Did Higgins, in this case, have any reason to assume that the natural and probable consequence of his acts along the line of his duties in controlling the traffic at the street intersection would be a sunstroke? Plainly not. The briefs show that the place where this sunstroke occurred is a busy street intersection, and we have a right to assume from the evidence that many

> other people were passing back and forth in the line of their regular duties across this street intersection on that day and that no other people so passing back and forth were stricken because of the heat. It would seem to require no argument, therefore, to conclude that from Higgins' duties at the intersection in question, although they were intentional and voluntary, a sunstroke would not be considered the natural and probable consequence of his course of action.

Since Higgins, the Illinois Supreme Court has continued to employ the same test as to whether an injury or damage has been caused by an "accident" under an insurance policy employing that term, in each case looking to the insured's intent or expectation. *See* Christ v. Pacific Mut. Life Ins. Co., 312 Ill. 525 (1924), Yates v. Bankers Life & Cas. Co., 415 Ill. 16 (1953). In the context of a liability policy, the court in United States Fidelity & Guaranty Co. v. Wilkin Insulation Co., 144 Ill.2d 64 (1991), likewise held that the test of an "occurrence" or "accident" is whether the damage was expected or intended by the insured.

The meaning of "occurrence" or "accident" is also well established in Illinois Appellate Court case law, perhaps best stated by the First District in International Minerals & Chemical Corp. v. Liberty Mutual Ins. Co., 168 Ill. App. 3d 361, 372 (1st Dist. 1988):

> In other words, under the "occurrence" definition standing alone, any unintended/unexpected damage will be covered as an "accident" without regard to the nature of the event causing it, to whether that event took place gradually or instantaneously or to the insured's intentions or expectations as to its incidence. Only damage which is intended or expected by the insured is omitted from coverage. Thus, in keeping with the designation of these insuring agreements as "comprehensive, general liability" policies, the class of events which initially qualify for coverage as an "occurrence" under this provision is potentially unlimited.

See also Lyons v. State Farm Fire and Cas. Co., 349 Ill. App. 3d 404 (5th Dist. 2004), Posing v. Merit Ins. Co., 258 Ill. App. 3d 827, 834 (3rd Dist. 1994), Western Cas. & Surety Co. v. Adams County, 179 Ill. App. 3d 752 (4th Dist. 1989), McAllister v. Hawkeye-Security Ins. Co., 68 Ill. App. 2d 222 (2nd Dist. 1966).

"Property damage"

The third issue that the court got wrong in Viking Construction was whether there was "property damage." The policy defined "property damage" as "physical injury to tangible property, including all resulting loss of use of that property." 358 Ill. App. 3d at 37. The author respectfully submits that a masonry wall is "tangible property" and that, if the brick, mortar, or other material thereof has cracked or broken, it has been "physically injured." The plain, ordinary, and popular meaning of the words compels this

conclusion. Any other result is a judicial re-definition, and that is what Viking Construction has done.

Viking Construction followed State Farm Fire and Cas. Co. v. Tillerson, 334 Ill. App. 3d 404 (5th Dist. 2002), in holding that, where the damage is to the defective construction itself, there is no "property damage." Instead, the damages are only in the nature of repair and replacement costs which are only economic losses, not property damage. 358 Ill. App. 3d at 54-55. Where does this reasoning come from? Certainly not from the policy language. It comes from Moorman Mfg. Co. v. National Tank Co., 91 Ill. 2d 69 (Ill. 1982). But Moorman and its progeny are concerned with drawing the proper line of demarcation between tort law and contract law, not with interpreting insurance policy language. Importing the Moorman doctrine into the insurance policy's definition of "property damage" results in the insurance policy covering only tort liability and never covering warranty or contractual liability. Yet, a close examination of many CGL policies reveals that they do cover warranty liability, *e.g.*, where the "completed operations hazard" is covered and is defined in a fashion to include warranties or representations concerning the fitness, quality, performance or use of "your work." *See* Western Casualty & Surety Co. v. Brochu, *supra.*

Importing Moorman into the policy's definition of "property damage" is also a backdoor avoidance of Illinois coverage law precedents which expressly state that the theory of liability pleaded by the complaint is not determinative for insurance coverage purposes. The Travelers Ins. Cos. v. P.C. Quote, Inc., 211 Ill. App. 3d 719, 729 (1st Dist. 1991), Management Support Associates v. Union Indemnity Ins. Co., 129 Ill. App. 3d 1089, 1097 (1st Dist. 1984), Lyons v. State Farm Fire and Cas. Co., 349 Ill. App. 3d 404, 407 (5th Dist. 2004).

The "property damage" holding of Viking Construction demonstrates the same, outcome driven approach that the court employed in re-interpreting "occurrence" and in importing a breach of contract exception into the "general coverage provision." This kind of analysis serves no one's interest, not the insured's nor the insurance industry's, as it contravenes accepted principles of insurance policy construction. As the Illinois Supreme Court has stated over and over:

> Our primary objective when construing an insurance policy is to ascertain and give effect to the intention of the parties, as expressed in the policy language. Hobbs v. Hartford Insurance Co., 214 Ill. 2d 11, 17, 823 N.E.2d 561, 291 Ill. Dec. 269 (2005); Traveler's Insurance Co. v. Eljer Manufacturing, Inc., 197 Ill. 2d 278, 292, 757 N.E.2d 481, 258 Ill. Dec. 792 (2001). The construction we give to an insurance policy should be a natural and reasonable one. De Los Reyes v. Travelers Insurance Cos., 135 Ill. 2d 353, 358, 553 N.E.2d 301, 142 Ill. Dec. 787 (1990). Undefined terms will be given their plain, ordinary and popular meaning, i.e., they will be construed with reference to the average, ordinary, normal,

> reasonable person. Outboard Marine Corp. v. Liberty Mutual Insurance Co., 154 Ill. 2d 90, 115, 607 N.E.2d 1204, 180 Ill. Dec. 691 (1992). If the policy language is susceptible to more than one reasonable meaning, it is considered ambiguous and will be construed against the insurer. Travelers Insurance Co., 197 Ill. 2d at 293. Importantly, a policy provision that purports to exclude or limit coverage will be read narrowly and will be applied only where its terms are clear, definite, and specific. National Union Fire Insurance Co. of Pittsburgh, Pennsylvania v. Glenview Park District, 158 Ill. 2d 116, 123, 632 N.E.2d 1039, 198 Ill. Dec. 428 (1994).

Gillen v. State Farm Mut. Auto. Ins. Co., 215 Ill. 2d 381, 393-394 (2005). *See also* Cent. Ill. Light Co. v. Home Ins. Co., 213 Ill. 2d 141, 153-154 (2004), Traveler's Ins. Co. v. Eljer Mfg., 197 Ill. 2d 278, 292-293 (2001), Employers Ins. v. Ehlco Liquidating Trust, 186 Ill. 2d 127, 141 (Ill. 1999).

As the court in Viking Construction acknowledged, the issue of coverage for construction defects is in great dispute, even "chaos" according to some commentators. 358 Ill. App. 3d at 17. Unfortunately, it is Viking Construction and cases like Tillerson, Hydra, and Wil-Freds which have created the chaos – by ignoring the plain wording of the policy and by judicially re-defining its terms.