No. 129087

In the

Supreme Court of Illinois

ACUITY,

Plaintiff-Petitioner,

v.

M/L HOMES OF CHICAGO, LLC,

Defendant-Respondent.

On Petition for Leave to Appeal from the Illinois Appellate Court, First Judicial District, No. 1-22-0023.
There Heard on Appeal from the Circuit Court of Cook County, Illinois, Count Department, Chancery Division, No. 19 CH 00237.
The Honorable Allen P. Walker, Judge Presiding.

AMICUS CURIAE BRIEF OF ASSOCIATED GENERAL CONTRACTORS OF AMERICA, AGC OF ILLINOIS, CENTRAL ILLINOIS BUILDERS OF AGC OF AMERICA, CHICAGOLAND AGC, NORTHERN ILLINOIS BUILDING CONTRACTORS ASSOCIATION, SOUTHERN ILLINOIS BUILDERS ASSOCIATION, AMERICAN SUBCONTRACTORS ASSOCIATION, NATIONAL ASSOCIATION OF HOME BUILDERS, AND HOME BUILDERS ASSOCIATION OF ILLINOIS, IN SUPPORT OF DEFENDANT-RESPONDENT

Clifford J. Shapiro
ARDC No. 6188824
SHAPIRO DISPUTE RESOLUTION LLC
615 Elmwood Ave.
Wilmette, IL 60091
Telephone: 847-207-2509
clifford@shapiroadr.com

Patrick J. Wielinski (pro hac vice)
ARDC No. 6343986
COKINOS / YOUNG
13335 Noel Road
Suite 1375
Dallas, Texas 75240
Telephone: 817-403-0955
pwielinski@cokinoslaw.com

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CYNTHIA A. GRANT
SUPREME COURT CLERK

Attorneys for Amici Curiae

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INTEREST OF AMICI CURIAE

This Amici Curiae brief is sponsored by national and state chapters of some of the largest construction trade associations in the United States. The sponsorship of these national organizations, in addition to their Illinois chapters, only underscores the importance of the insurance coverage issues to be addressed by the Court in this proceeding, both for Illinois construction businesses, as well as construction businesses on a national basis.

The **Associated General Contractors of America** (AGCA) is a nationwide trade association of commercial construction companies and related firms. It has served the construction industry since 1918, and over time has become the recognized leader of the construction industry in the United States. The association now has more than 27,000 firms, including 7,000 of America's leading general contractors, nearly 9,000 specialty contracting firms and more than 11,000 service providers and suppliers that belong to the association through its nationwide network of 89 chartered Chapters. AGC members are engaged in building, heavy, civil, industrial, utility, and other construction for both public and private property owners and developers. AGC's website is https://www.agc.org/ and state chapter websites can be accessed at https://www.agc.org/connect/chapters.

The **Associated General Contractors of Illinois** (AGCI) advocates for the highway, heavy, and utility contracting industry in Illinois. AGCI represents 250 members, with their yearly volume at $1.6 billion.

Central Illinois Builders of AGC of America (CIB) represents over 90 members dedicated to improving the construction industry. The association promotes integrity and responsibility in all matters between owners of construction projects and all segments of the construction industry public and private. CIB is committed to improving the professional standards of the construction industry along with skill and responsibility.

Chicagoland AGC is the leading unified voice of commercial construction in the region representing the finest union contractors. Chicagoland AGC has 245 members who account for over 10,000 employees and over $12 billion in economic activity annually. Its mission is to empower its members through labor and government relations, ongoing education, and business relationships.

The **Northern Illinois Building Contractors Association** (NIBCA) represents over 100 general and specialty contractors in the nine Northwestern counties of Illinois. NIBCA's contractor members put well over a billion dollars of construction in place each year and employ several thousand tradesmen. NIBCA is active in representing its members in public policy issues that relate to efficiency and quality performance on behalf of clients and the community as a whole. In addition to other areas of expertise, association affiliates include insurance professionals who act as advisors on matters involving Construction Industry Standards and Methods.

Southern Illinois Builders Association (SIBA) represents over 450 members in the southern 39 counties of Illinois. The mission statement of SIBA is to advance the construction industry by strengthening its members by enabling them to do collectively what they cannot accomplish on their own. SIBA offers a full range of services and programs to provide value to its members as the voice of the construction industry in Southern Illinois.

The **National Association of Home Builders** (NAHB) is a trade association representing more than 140,000 builder and associate members organized into approximately 600 affiliated state and local associations in all fifty states, the District of Columbia, and Puerto Rico. NAHB's interest is in seeing that suppliers of housing can do the job they are most qualified to do, that is, to build and operate affordable housing for millions of Americans. NAHB is the voice of the American shelter industry, and its members construct over 80% of the housing in the United States. NAHB's goals are to promote home ownership; to foster a healthy and efficient housing industry; and to promote policies that will keep safe, decent, and affordable housing a national priority. NAHB's website is at www.nahb.org.

The **Home Builders Association of Illinois** (HBAI) is the watchdog for builders, contractors, developers, and all those involved in home building across Illinois. There are 11 local associations in Illinois. HBAI is an affiliate of NAHB that shares its objectives. HBAI's website is https://hbai.org/.

The **American Subcontractors Association, Inc.** (ASA) is a non-profit corporation supported by the membership dues paid by approximately 5,000 members nationally and throughout Illinois. All ASA member businesses are construction subcontractors and suppliers.

Because of their unique perspectives as influential representatives of broad segments of the construction industry, these organizations have all submitted amicus curiae briefs in numerous jurisdictions on the very issues before this Court. Moreover, they have a great interest in the many risks that inhere in the construction process, and insurance has long played a significant role for their members in managing those risks. Whether AGC, ASA, or NAHB members can depend on their general liability insurance policies to provide some reasonable degree of protection against financial harm as marketed by the insurance industry is a matter of continuing and urgent interest to the members of all of these organizations. Consequently, though Amici Curiae are not parties to this appeal, this brief was filed by Amici Curiae through the undersigned independent counsel, who was paid a fee by them for its preparation.

INTRODUCTION

Amici Curiae, as well as other businesses engaged in construction within the State of Illinois, confront the questions certified to this Court in managing the considerable risks associated with their endeavors. While Illinois contractors and subcontractors strive and usually succeed in providing

quality construction services to owners and upper tier contractors, occasionally inadvertent mistakes occur, mistakes that can result in defects in construction. Commercial general liability (CGL) policies insure nearly all participants in the construction industry, including non-residential general contractors, residential homebuilders, subcontractors and material and equipment suppliers, together with all other parties that are affected by defective construction.[1] These parties include project owners, both public and private, as well as homeowners. Illinois insureds have always paid substantial premiums for liability insurance to provide protection from liability for the property damage arising out of construction defects.

The arguments made by insurers such as Acuity, A mutual insurance company ("Acuity"), in this appeal willfully disregard (and fail to explain) the revisions to the CGL policy form that were made by the insurance industry itself to eliminate many of the bases for denial that Acuity and other insurance companies nonetheless continue to advocate to the courts. It is this threat to the insurance coverage that is intended to be provided under the modern day CGL policy form that united AGC, ASA, NAHB and local chapters in submitting this brief in support of the position of Defendant-Appellee, M/I Homes of Chicago ("M/I Homes"). The Amici Curiae unanimously urge the

[1] For simplicity's sake, the analysis in this brief often uses the generic terms "contractor" or "builder." This term includes home builders; subcontractors; and non-residential commercial building, industrial, heavy highway/civil, and utility infrastructure contractors; and other participants in the construction industry, unless otherwise indicated.

Court to apply the standard CGL policy before this Court in accordance with its explicit terms to provide the policyholder with the intended scope of coverage, and in doing so, correct the incorrect analysis that came to exist — and which currently exists — under Illinois law. In short, the Amici Curiae ask this Court to join the ever-growing number of courts that have corrected the outdated and incorrect analysis of the modern day CGL policy in their jurisdictions by finding that inadvertent defective construction work can constitute an "occurrence" that causes covered "property damage" under the CGL policy.[2]

Acuity and the brief filed by its supporting Amici Curiae, the Complex Insurance Claims Litigation Association, and the American Property Casualty Insurance Association (collectively the "Insurer Amici"), crystallize the studied attempt of insurers such as Acuity to rewrite and significantly reduce the coverage that is intended to be provided (and which should be provided) by the modern day CGL insurance policy. They offer up little more than philosophical diatribes that are divorced from the actual terms of the current policies sold to Illinois contractors.

By denying coverage for otherwise valid claims presented by Illinois insureds, Acuity and Insurer Amici place Illinois construction businesses at a

[2] While Amici Curiae have limited their arguments in this brief to certain coverage issues as to "occurrence" for "property damage" as to defective work, they support and adopt the positions of M/I Homes as to the obligation of Acuity to defend the allegations made against it in the Underlying Lawsuit, as well as the standing of Church Street Townhomes Owners Association to sue on behalf of individual owners for damage to "other property".

competitive disadvantage because they are unable to rely on the legitimate transfer of risks to their insurers. This is a serious issue, not only for the Illinois construction industry, but the entire state, considering that the industry contributes $32 billion to the Illinois GDP.[3] As set out below, construction insureds in a majority of other states are able to count on the actually intended transfer of risk under their CGL policies in support of their businesses. Illinois insureds, however, cannot count on the same protection because current Illinois law ignores or fails to correctly apply the actual terms of the modern day CGL policy.

In fact, the Illinois appellate court has expressly admitted in recent decisions that current Illinois law expressly engrafts a requirement for coverage that is simply not found in the CGL policy itself, namely, that only damage to property outside the scope of work of the insured (which, for a general contractor is the entire construction project) is potentially within coverage. As advocated by insurers such as Acuity, this "engrafted" requirement (which is ***not*** found in the modern day CGL policy itself) renders the CGL policy of far less value both for general contractors and the entire Illinois construction industry.

Generally, buildings and other improvements are built pursuant to contracts in which the contractor obligates itself to construct the project in

[3] Annualized as of the 3rd quarter of 2022. Macrina Wilkins, THE ECONOMIC IMPACT OF CONSTRUCTION IN THE UNITED STATES AND ILLINOIS, AGC of America, April 2023.

accordance with the plans and specifications. Thus, one risks is that the project will not be built according to those plans and specifications, resulting in construction defects. Some risks of defective workmanship are insurable. Contrary to the strained arguments of insurers such as Acuity, a construction defect that causes property damage that is neither expected nor intended is, and always has been, an "occurrence" under the CGL policy.

This does not mean, and Amici Curiae certainly do not contend that every construction defect is an "occurrence," the repair of which is insured under a CGL policy. Obviously, intentionally sloppy or shoddy workmanship that damages a project is not an "occurrence." But at the same time, simply because the performance of faulty workmanship may breach the construction contract, it does not follow that the property damage resulting from that faulty workmanship is, to use the terminology employed in the policy itself, ***"expected or intended from the standpoint of the insured."*** Certainly, those damages are not by definition foreseeable for purposes of CGL coverage as Acuity contends.

The disingenuous interpretation of the definition of "occurrence" argued by Acuity before this Court is a major disconnect from the interpretation of coverage as marketed to purchasers of CGL policies, including thousands of AGC, ASA and NAHB members, both in Illinois and elsewhere. That marketing emphasizes the availability of coverage for various categories of defective work, including property damage arising out of the work of the

insured's subcontractor or damage to non-defective portions of the work—regardless of whether the named insured or a subcontractor performed it. As explained in detail below, the coverage intended to be provided under the modern day CGL insurance policy is accomplished through an intricate series of construction-specific exclusions, exclusions which the insurance industry itself has recognized are meant to preserve coverage for certain kinds of property damage caused by inadvertent construction defects.

If property damage to a home or a project itself can never constitute an accidental "occurrence," then the carefully crafted construction-specific policy exclusions created by the insurance industry are rendered meaningless. At the same time, this result can only be accomplished by violating basic tenets of insurance policy contract interpretation – such as the requirement that the insurance contract be interpreted as a whole. Unlike Acuity's argument that would require this Court to deep-six the terms of the policy itself in favor of vague principles of inapplicable law, Amici Curiae ask nothing from this Court but to address the concerns expressed by Judge Mikva and apply the express language of the entire CGL policy before it.

SUMMARY OF THE ARGUMENT

The arguments of Acuity and similarly situated insurers all suffer a fatal flaw in that they do not address, but rather purposefully ignore the very terms of the CGL policy under which they seek to evade their obligations. If this Court accepts such arguments, it will be placed in the anomalous position

of interpreting a standard form contract in use throughout the state of Illinois, and throughout the United States, without giving due consideration and meaning to all of the terms of the standard contract itself.

Acuity's arguments, which forsake the terms of its standard CGL policy and the response of Amici Curiae to them, include:

- A CGL policy distinguishes between liability in tort versus liability and breach of contract. ***It does not***.
- Property damage to the project flowing from a breach of contract is natural and ordinary and not an accidental "occurrence" under the CGL policy. ***No. Property damage caused by inadvertent defects in construction work is caused by accidental, not intentional conduct. It is therefore an accidental "occurrence" under the CGL policy.*** Simply because the damage at issue is to property that is the subject matter of the contract does not somehow make the damage expected or intended, or somehow not accidental.
- The economic loss rule determines coverage under a CGL policy. ***No. The economic loss rule is a remedies defense.*** It has no effect whatsoever on whether the property damage under the CGL policy is unexpected and unintended, and thus an "occurrence" under the policy. Any restriction that limits coverage

to "other property" must be based on the terms of the CGL policy, and there are no such terms in the modern-day policy.

- Damages flowing from defective work in breach of a construction contract are necessarily an uninsured economic loss. ***No.*** Many damages arising out of inadvertent construction defects performed in breach of a contract cause physical injury to tangible property, including damage to other elements of the insured's work or that of other contractors, and this physical injury to tangible property clearly satisfies the definition of "property damage" under the CGL policy.
- Coverage for an insured builder for its subcontractor's work cannot be created by an exception to an exclusion. ***No. This argument only seeks to circumvent the correct interpretation of the CGL policy.*** The provision in Exclusion (l) that states that the exclusion does not apply where a subcontractor performed the work does not "create" coverage; rather, it simply "preserves" coverage that exists by virtue of the initial coverage grant of the policy for an "occurrence" of unexpected and unintended "property damage."
- Upholding coverage for property damage arising out of defective work transforms the CGL policy into a performance bond. ***No. Occurrences of unexpected and unintended property***

damage may trigger both the policy and the bond. The CGL policy ultimately provides coverage in those instances. A CGL policy never functions as a performance bond.

By presenting these arguments in isolation from the policy terms, insurers such as Acuity try to ignore and avoid the effect of the carefully drafted construction-specific policy exclusions that ***specifically anticipate*** the accidental "occurrence" of inadvertent construction, and which define the scope of coverage for resulting property damage. Instead, insurers such as Acuity try to use the above arguments to advance the false notion that a CGL policy does not cover a contractor's risk of property damage to anything within the contractor's scope of work.

This coverage dispute presents a textbook example of how the property damage exclusions tailor the coverage for insured contractors and subcontractors, entitling them to coverage for carefully defined business risks, including damage to otherwise non-defective work and defective workmanship performed by their subcontractors. Therefore, Amici Curiae ask this Court to do nothing more but read and apply the express terms of the policy.

ARGUMENT

The merits of the dispute before this Court appear to be of a somewhat mundane nature, as to whether an allegation in a complaint that the insured's work damaged "other property" is sufficient to trigger a duty defend. The First District of the Illinois Appellate Court quite rightly held that it did. In addition,

Judge Mikva also questioned the basis of the "other property" requirement for an "occurrence" under Illinois law because this requirement does not exist in the actual terms of the modern day CGL policy. There is no doubt that Judge Mikva correctly raised this question, as Illinois law regarding the "occurrence" issue is currently based on a deeply flawed analysis that fails to apply the actual terms of the modern day CGL policy. Amici Curiae urge the Court to take this opportunity to apply the terms of the standard CGL policy such that it reflects the actual coverage intent of the policy, and to provide clarity for future claims involving defective construction work in Illinois.

Acuity's attempts to reduce coverage through policy interpretation arguments bereft of the language of the policy itself cannot be sanctioned by this Court. Under Illinois law, the construction of an insurance policy is a question of law, subject to *de novo* review and the rules applicable to contract interpretation. The primary objective when construing an insurance policy is to ascertain and to give effect to the intention of the parties, as expressed in the policy language. The construction should be a natural and reasonable one. 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. *Sproull v. State Farm Fire & Cas. Co.*, 2021 IL 126446, ¶ 19. Moreover, "[t]he court will not adopt an interpretation that 'rests on gossamer distinctions' that the average person, for whom the policy is written, cannot be expected to understand.'" *Id.*

The position advocated by Acuity and its Insurer Amici violate each and every one of these rules of policy interpretation. The policy insuring agreement makes no "gossamer distinction" between property damage arising out of breach of contract and tort, let alone between damage to property that is within or not within the scope of work of the insured or damage to "other property." This terminology simply is not found in the policy (nor in the intent behind it).

It is little wonder why insurers such as Acuity try to cut the policy off at the knees, by focusing only on invalid "occurrence" and "property damage" arguments. By doing so, they can ignore the intended coverage that exists when the key construction-specific policy exclusions are considered under a proper analysis that considers the policy as a whole. This is particularly true where, as here, the claim involves property damage preserved by those very exclusions. In short, acceptance of Acuity's arguments prevents application of the carefully tailored property damage exclusions designed to preserve coverage for insured builders for property damage to non-defective work on the project or arising out of their subcontractors' work.

I. THE CGL POLICY COVERS UNFORESEEN AND UNINTENDED PROPERTY DAMAGE TO THE INSURED'S WORK

Insurers such as Acuity and the Insurer Amici fixate on the "occurrence" requirement to attempt to omit any discussion of the exclusions contained in the CGL policy and their profound effect upon insurance coverage for defective work claims. In this regard, one of the key exclusions in the CGL policy is the Your Work Exclusion. Though labeled an exclusion, that provision actually

preserves coverage under many circumstances, including the facts of this case. Exclusion l, the Your Work Exclusion states that the insurance does not apply to:

> l. "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

The term "your work" refers to work of the insured contractor and its subcontractors. The exclusion applies to property damage that is included in the "products-completed operations hazard," and the townhome project, at the time the property damage occurred, was a "completed operation," since all work had been completed under M/I's contract and the jobsite had been put to its intended use. .

M/I Homes subcontracted work under its contract to subcontractors, including H&R Exteriors Inc (H&R) and H&R's caused property damage. For that reason, the Your Work Exclusion does not apply to this claim. The second sentence of the Your Work Exclusion, often referred to as the "subcontractor exception," explicitly states that the exclusion does not affect coverage where the damage arises out of work performed by a subcontractor on behalf of the named insured. In effect, it expressly preserves coverage that already exists under the insuring agreement. Based on the false premise that property damage arising out of defective work is never covered, insurers such as Acuity

focus on the definition of occurrence under the CGL policy, declining to consider the plain language of the subcontractor exception.

A. The Historical Development of the CGL Policy Establishes Coverage

This Court should not depart from the plain language of the CGL policy. Admittedly, there is a perceived tension between CGL coverage for defective work and what insurance underwriters have traditionally referred to as an uninsured business risk, that is, ordinary "business risks" the insured can supposedly control. This perception gained momentum with the 1966 revisions to the CGL form promulgated by the Insurance Services Office ("ISO"), the industry organization responsible for drafting the industry-wide standard forms. The Work Performed Exclusion in the 1966 revisions (Exclusion (o)), broadly excluded coverage for property damage arising out of "work performed by or on behalf of the named insured." The exclusion was retained in the 1973 revision of the form, but that same year, ISO promulgated the Broad Form Property Damage Endorsement ("BFPDE") to the standard policy form. That endorsement expanded the coverage under the 1973 form by modifying the Work Performed Exclusion to delete from it the reference to work performed "on behalf of" the named insured, that is, work performed by subcontractors. The intent was to provide an insured contractor with coverage for property damage arising out of the defective work of its subcontractors. 21 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE §132.9[D] (2d ed. 2002).

The policies before this Court are written on a form that was revised in 1986. Those revisions were widely hailed throughout the insurance industry, both for their simplification (purported at best) and reduction of the number of forms, as well as their use of more plain language. 20 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE §129.1[C] (2d ed. 2002). One of the simplifications sought by ISO was to clarify the limitations on the business risk concept previously introduced in 1973 by the BFPDE. Due to the popularity of the enhanced coverage provided by the BFPDE, one major revision was the explicit insertion of the exception for work performed by subcontractors into the Your Work Exclusion, as part of the standard coverage of the policy. That revision affirmatively stated and confirmed the existence of completed operations coverage for property damage arising out of the work of subcontractors.[4]

Of course, the addition of the express subcontractor exception into the CGL policy form made the coverage more attractive to construction insureds, as recognized by the Florida Supreme Court in *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007):

> "[T]he insurance and policyholder communities agreed that the CGL policy should provide coverage for defective construction claims so long as the allegedly defective work had been performed

[4] The 1986 revisions also simplified the BFPDE by adding newly worded Exclusions j(5) and j(6), exclusions that are limited to only to property damage occurring while construction operations are in progress. But they exclude only the "particular part" of property upon which the named insured is performing operations, or which must be repaired or replaced due to the named insured failing to perform its work correctly upon it. Coverage to other work is preserved under the "particular part" limitations. *Mid-Continent Cas. Co. v. JHP Dev., Inc.,* 557 F.3d 207 (5th Cir. Tex. 2009). Likewise, these exclusions would serve little purpose if damage beyond the defective item of the work were not an "occurrence."

> by a subcontractor rather than the policyholder itself. This resulted both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of insurers that the CGL was a more attractive product that could be better sold if it contained this coverage."

U.S. Fire Ins. Co., 979 So.2d at 879 (quoting from 2 Jeffrey W. Stempel, *Stempel on Insurance Contracts* §14.13[D] at 14-224.8 (3d ed. Supp. 2007)).

Authoritative commentary summarizes the intent of the insurance industry to eliminate the confusion over CGL coverage for subcontractor work through the 1986 revisions. International Risk Management Institute Inc. (IRMI), a source universally relied upon by both insurers and insureds alike, states as follows:

> By virtue of the subcontractor exception, the insured has coverage, despite exclusion I., with respect to the following exposures.
>
> - Property damage to work performed by the insured when the damage results from the work of the insured's subcontractor
> - Property damage to work performed by the insured's subcontractor when the damage results from that subcontractor's work
> - Property damage to work performed by the insured's subcontractor when the damage results from work performed by the insured
> - Property damage to work performed by the insured's subcontractor when the damage results from the work of another contractor or subcontractor.

INTERNATIONAL RISK MANAGEMENT INSTITUTE, COMMERCIAL LIABILITY INSURANCE (2016).[5]

[5] Available at: https://www.irmi.com/online/products/commercial-liability-insurance/cgl-coverage-forms-detailed-analysis/2013-iso-commercial-general-liability-policy/bodily-injury-

The subcontractor exception unambiguously preserves from exclusion coverage for the property damage claim of M/I Homes, and in light of the history and purpose of the provision, it is disingenuous of Acuity and the Insurer Amici to attempt to avoid it through arguments that focus exclusively on the definition of occurrence.

B. Acuity's Arguments Do Not Address the 1986 CGL Forms Before this Court

Acuity and the Insurer Amici rely upon case law that does not address the policy form upon which the Acuity policy is written. They cite authorities that for the most part interpret the older 1973 or even the 1966 policy forms without enhancements such as the subcontractor exception applicable to completed work or the "particular part" limitation on exclusion of property damage occurring while work is in progress. In doing so, they compare apples to oranges and spoil the fruit salad for their insureds.

The case law relied upon Acuity and the Insurer Amici shares a common genesis in the obsolete New Jersey opinion, *Weedo v. Stone–E–Brick, Inc.,* 405 A.2d 788 (1979). For over the nearly forty years during which it held sway, *Weedo* was cited by nearly 350 opinions throughout the United States, including Illinois. In those opinions, insurers such as Acuity argued, usually successfully, that property damage arising out of defective or faulty construction was not covered under a CGL policy, convincing courts to abandon

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and-property-damage-liability-(coverage-a)/exclusions-bodily-injury-and-property-damage-liability-(coverage-a)/subcontractor-exception-to-the-damage-to-your-work-exclusion

the terms of policies and to embrace an unfettered "defective work as business risk doctrine." But as set out below, most of those authorities are inapposite and outmoded, in that they address coverage under prior policy forms, which simply are not the policy forms before this Court.

The courts of Illinois were no exception in terms of embracing *Weedo*. The case has been cited by insurers on numerous occasions for various propositions to support a denial of defense and coverage for insureds, mostly contractors, as argued by Acuity before this Court. These propositions include a false distinction between tort versus breach of contract damages; property damage arising from defective work in breach of a contract is natural and ordinary, and thus cannot constitute an "occurrence;" and property damage arising from defective work, except to "other property" constitutes economic damage for breach of contract, and not property damage.

In *Weedo*, a claim was made against the insured contractor for faulty masonry work on a home. In the course of ultimately denying coverage, the court engaged in an extended analysis of insurable versus uninsurable risks. However, that analysis applied to the limited coverage under the 1973 CGL policy form before the court. That policy form was ***not*** endorsed with a BFPDE so it was not intended to provide for an exception providing coverage for subcontractors' work. As such, the court's analysis was relatively

uncomplicated, though inapplicable to other cases, including Illinois precedent stretching from 1984 to 20l1 that embraced it.[6]

In support of its denial of coverage, the *Weedo* court quoted from a law review article published in 1971, the rationale of which is helpful to understand the weakness of this precedent:

> The risk intended to be insured is the possibility that the goods, products or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable. The insured, as a source of goods or services, may be liable as a matter of contract law to make good on products or work which is defective or otherwise unsuitable because it is lacking in some capacity. This may even extend to an obligation to completely replace or rebuild the deficient product or work. This liability, however, is not what the coverages in question are designed to protect against. The coverage is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained.

R. Henderson, *Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know,* 50 NEB. L. REV. 415, 441 (1971).

This all sounds very familiar (if one reads insurers' briefs), but this law review article, for better or for worse, along with *Weedo*, is one of the most frequently cited authorities in connection with the denial of coverage for

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[6] *Qualls v. Country Mut. Ins. Co.*, 123 Ill. App. 3d 831 (4th Dist. 1984); *Western Cas. & Sur. Co. v. Brochu*, 105 Ill. 2d 486, 498 (1985); *Home Indem. Co. v. Wil-Fred's, Inc.,* 235 Ill. App. 3d 971 (2d Dist. 1992); *Monticello Ins. Co. v. Wil-Freds Constr., Inc.*, 277 Ill. App. 3d 697 (2d Dist. 1996); *Pekin Ins. Co. v. Richard Marker Assoc., Inc.*, 289 Ill. App. 3d 819 (2d Dist. 1997); *Stoneridge Dev. Co. v. Essex Ins. Co.*, 382 Ill. App. 3d 731, 749 (2d Dist. 2008); *Nautilus Ins. Co. v. 1735 W. Diversey, LLC*, No. 10 C 425, 2011 WL 3176675 (N.D. Ill. July 21, 2011).

defective workmanship to an insured contractor.[7] At the time of its publication in 1971, the 1973 revisions to the CGL policy were already in the works, thus rendering the article's analysis dated and moot for subsequent policies. The primary purpose of the Henderson article was to analyze the ***1966*** revisions to the CGL form and, more specifically, to analyze the dichotomy established in those revisions between the "products hazard," the hazard applicable to product manufacturers, and the "completed operations hazard," the hazard describing the risks associated with service providers such as construction contractors. The article contains no analysis as to the effect of the addition of the exception for a subcontractor's work through the BFPDE in 1973, or of course, the addition of the Subcontractor Exception to the 1986 forms. Thus, the sweeping business risk doctrine as described by Henderson has been drafted out of the newer policy forms by insurers, like Acuity and the Insurer Amici, willing to expand coverage in order to sell policies and collect additional premiums from insureds.

Therefore, the *Weedo* case, and its reliance upon the Henderson law review article became the cornerstone of arguments by insurers like Acuity that the business risk doctrine applies to support a ***carte blanche*** denial of coverage for defective workmanship claims, ***regardless*** of the fact that the

[7] For example, the Henderson law review article has been cited in nearly 200 court opinions, with the vast majority in support of denials of coverage related to faulty work. And many of those opinions rely on both authorities. Together with *Weedo,* the Henderson law review article has been cited by Illinois courts to support the restriction of coverage. *See, Home Indemnity v. Wil-Fred's*, and *Western Cas. & Sur. v. Brochu, supra,* note 4.

policy language has changed dramatically over the years. Nevertheless, the Insurer Amici includes a stale (but somewhat pithy) quotation from *Weedo* at pages 12-13 of their brief that "the CGL policy "does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident." *Western Cas. & Sur. Co. v. Brochu*, 105 Ill. 2d 486, 498 (1985) (citation omitted).

The "citation omitted" by the Insurer Amici from *Bruchu* is to *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788, 796 (N.J. 1979), and it is somewhat transparent why they chose to drop it. In 2016, *Weedo's* improbable 36-year reign in New Jersey and throughout the United States came to an end with the New Jersey Supreme Court's decision in *Cypress Point Condo. Ass'n, Inc. v. Adria Towers, L.L.C.*, 143 A.3d 273 (N.J. 2016). Similar to this case, the condominium association brought construction defect claims against the developer and general contractor, its insurers, and various subcontractors who performed the faulty construction work on the building project.

The New Jersey Supreme Court rejected the insurers' argument that, under *Weedo* and its progeny, damage caused by faulty work is foreseeable and is a breach of contract that cannot result in an occurrence under a CGL policy. The court stated that the insurers failed to recognize that the decision in *Weedo* was based on the exclusions in the 1973 CGL policy form. Further, the court pointed out that the policy in *Weedo* defined "occurrence" differently and did not have a subcontractor exception to the Your Work Exclusion, whereas the policy in *Cypress Point* was written on the 1986 ISO form, which included the subcontractor exception and defined occurrence as an "accident."

Cypress Point Condo Ass'n, Inc., 143 A.3d at 281. This 1986 form is the same form before this this Court upon which the Acuity policy is written. The court then determined that, although the Your Work Exclusion would seem to preclude coverage for the claimed damages, the subcontractor exception to the your work exclusion restored coverage because the water damage arose out of subcontractors' defective work. *Id.* at 289.

The New Jersey Supreme Court's opinion in *Cypress Point* is significant because it distinguished *Weedo v. Stone-E-Brick* by determining that its analysis does not apply to the post-1986 CGL policy forms. *Id.* at 288. The court essentially relegated it to mere historical significance, a positive development for insured contractors, seeking coverage under their CGL policies for property damage caused by a subcontractor's defective work, not only in New Jersey, but throughout the United States. It crystalizes the shift from occurrence-based arguments to application of standard and manuscripted property damage exclusions. Turning a blind eye to this shift, Acuity and Insurer Amici are hopelessly (but apparently willingly) mired in the past, at least when it comes to denying coverage to Illinois contractors and builders. This Court can call their bluff.

II. THE PERFORMANCE OF DEFECTIVE WORK IN BREACH OF CONTRACT CAN OFTEN INVOLVE AN "OCCURRENCE" OF UNEXPECTED AND UNINTENDED "PROPERTY DAMAGE"

Insurers such as Acuity and the Insurer Amici attempt to deny coverage for defective work claims based upon an incomplete analysis of "occurrence"

that raises only generalized arguments that do not apply the actual terms of the modern day CGL policy itself. Those arguments include (a) a false distinction between tort versus breach of contract damages for purposes of coverage; (b) that property damage arising from defective work in breach of a contract is natural and ordinary, and thus cannot constitute an "occurrence;" and (c) that the economic loss rule dictates that all damages arising from defective work constitute economic damages for breach of contract, and not property damage. All of these arguments suffer the same basic flaw: whether the damage arises out of a breach of contract is irrelevant for coverage under a CGL policy because the policy makes no distinction between tort and breach of contract damages. The key to satisfaction of the insuring agreement of the CGL policy is a legal obligation of the insured builder to pay the damages caused by property damage arising out of an "occurrence," defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

At the same time, Acuity and the Insurer Amici fail to recognize that a proper policy analysis does not consider the intentional nature of the actions that result in property damage, but rather, upon the unexpected nature of the damages themselves. As early as 1991, this Court rejected the efforts of the insurers of an asbestos installer to misconstrue the notion of occurrence so as to over-emphasize the intention to install asbestos itself rather than the property damage resulting from it. In *U.S. Fidelity & Guar. Co. v. Wilkin*

Insulation Co., 144 Ill. 2d 64, 77-78 (1991), this Court held that in terms of occurrence, "it is the contamination of the buildings and their contents that must be neither expected nor intended by Wilkin [the insured]. We have reviewed the underlying complaints and are unable to find any allegations that Wilkin "expected or intended" to contaminate the buildings and the contents therein with toxic asbestos fibers." Of course, the same applies to the allegations against M/I Homes. It did not expect or intend to build homes that leaked.

This standard has been consistently applied by Illinois courts. When used in insurance policies, the word "occurrence" broadens coverage and eliminates the need to find an exact cause of damages, as long as they are neither intended nor expected by the insured, but the occurrence must be accidental. *See State Farm Fire & Cas. Co. v. Tillerson*, 334 Ill. App. 3d 404, 408 (5th Dist. 2002); *Bituminous Cas. Corp. v. Gust K. Newberg Const. Co.*, 218 Ill. App. 3d 956, 966 (1st Dist. 1991). In addition, an accident is defined as "an unforeseen occurrence of untoward or disastrous character" or "an undesigned sudden or ***unexpected*** event." The natural and ordinary consequences of an act do not constitute an accident. *Bituminous Cas. Corp. v. Gust K. Newberg Const. Co.*, 218 Ill. App. 3d 956, 966 (1st Dist. 1991) (citing, *Aetna Casualty and Surety Co. v. Freyer*, 89 Ill. App. 3d 617, 619 (1980) (emphasis added)).

There can be no serious question under this law that the allegations against M/I homes in this case allege physical "property damage" caused by an

accidental "occurrence." There is no allegation that M/I Homes expected or intended to build homes that leaked. And there is no allegation that any specific construction error that caused property damage was in any way performed incorrectly on purpose. To the contrary, it is undisputed that this case is about *inadvertent* construction defects that accidentally caused property damage to something other than the defective work itself.

Even Acuity and the Insurer Amici do not contend that builders (including the builder in this case) expect or intend to breach their contracts and perform their work in a defective manner.[8] Despite the best of efforts, on some occasions, work is performed incorrectly, and that work may result in unexpected and unintended property damage. That type of property damage, unless excluded by the property damage exclusions under the policy, is covered under the modern day CGL policy.

[8] Nonetheless, Acuity's brief is rife with misunderstandings or plain misstatements as to how the construction industry does business. For example, at page 22-23, Acuity asserts that where the insurer denies CGL coverage for repair of property damage caused by its defective work, it avoids "double recovery" to the contractor. Nothing could be further from the truth. While a contractor is paid for the original construction, it is obligated in its contract to repair the defective workmanship at its own cost (or suffer a lawsuit). Those repairs constitute the measure of damages for which the contractor is legally obligated to pay because of "property damage," within the terms of the insuring agreement of the Acuity policy. Alternatively, if suit is filed by the owner against the contractor, the damages are determined by the finder of fact. The insurance indemnifies the contractor for the cost of repair or the damages assessed against it. Such a result is particularly appropriate where, as in this case, the property damage was caused by subcontractors, and it in no way results in a "double recovery."

A. The CGL Policy Does Not Distinguish Between Tort Versus Breach of Contract Damages

The undercurrent of Acuity's argument as to the meaning of "occurrence" is that an insured builder's liability for property damage caused by defective work involves a breach of contract. Since virtually the entire construction industry does business based on written contracts, if that argument were to succeed, a CGL policy would be of much less utility to the construction industry. The fallacy that coverage only exists for damage to property other than the project itself, and its departure from the language of the policy was implicit in the First Judicial District opinion below.

Fortunately, these arguments raised by insurers cannot survive scrutiny when compared with the language of the CGL policies that they themselves write because CGL policies do not distinguish between liability in tort over breach of contract. For example, since an "occurrence" involves injury that is unexpected or unintended from the standpoint of the insured, many torts, such as intentional torts, are not "occurrences." At the same time, inadvertent breaches of contract can result in property damage neither expected nor intended by the insured.

Commentary from the insurance industry itself establishes that no "tort versus breach of contract" dichotomy was contemplated for purposes of the coverage grant in the insuring agreement of the CGL policy. The landmark and longstanding commentary by George H. Tinker, the Associate General Counsel

of Kemper Insurance Companies, on the 1973 CGL policy form revisions makes clear that the drafter's intent was for breach of contract damages to be covered:

> The coverage agreement embraces 'all sums which the insured shall become legally obligated to pay as damages…' That portion of the coverage grant is intentionally broad enough to include the insured's obligation to pay damages for breach of contract as well as for tort, within limitations imposed by other terms of the coverage agreement (e.g., bodily injury and property damage as defined, caused by an "occurrence") and by the exclusions …

George H. Tinker, *Comprehensive General Liability Insurance—Perspective and Overview*, 25 FED. INS. COUN. Q. 217, 265 (1975). The coverage grant in the current edition of the standard CGL policy, including the policy before this Court, is virtually unchanged from the 1973 revision.[9]

Acuity and the Insurer Amici raise the false distinction between tort and breach of contract to bootstrap their oft-stated position that costs to repair defective work amount to pure uninsured economic loss, even where, as here, the claim involves physical injury to tangible property, relying on *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 197 Ill. 2d 278 (2001). Their position however finds no support in *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 197 Ill. 2d 278 (2001). Insurers and insureds alike acknowledge that this Court's opinion in that case is perhaps the leading case as to CGL coverage for incorporation of a defective product into a project where there has been no property damage. Obviously,

[9] In relevant part, the coverage grant in the Acuity policy broadly states: "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."

Acuity and the Insurer Amici fly far afield when trying to force the square facts of this appeal into the round hole of *Eljer* to support the denial of coverage.

In *Eljer*, the issue was whether CGL coverage existed for ***future*** leaking and damage because of defective Qest plumbing systems installed in thousands of homes that had not yet failed. Quite naturally, this Court held that repair costs for the plumbing that had not yet failed did not meet the definition of "property damage" in the CGL policy.[10] *Id.* at 502. The townhomes in the case at bar are tangible property that have suffered extensive physical injury in that the failure has already occurred and caused water damage to the claimant's property. To paraphrase holding of this Court, the townhomes, as "tangible property," suffered physical injury when the property was altered in appearance, shape, color, or another material dimension," *Eljer*, at 301-02. That physical injury to the townhomes included moisture-damaged or water-damaged fiber board, water-damaged OSB sheathing, deteriorated brick veneer, and prematurely deteriorating "support members below the balcony deck boards as a result of the exterior defects in the homes."(App. Ct. ¶10)

The *Eljer* court also stated the converse: tangible property does not experience physical injury if it suffers "intangible damage, such as diminution in value as a result of a failure of a component, such as the Qest System to

[10] "Property damage" is defined in relevant part in the Acuity policy as: 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 Loss of use of tangible property that is not physically injured.

function as promised." *Id.* at 302. This is the "economic loss" referred by the court throughout the opinion. Again, the damage to the townhomes had already occurred. The townhome owners were living with the damage, and it was by no means the product of fear of future failure or damage. It was not mere economic loss to the townhome owners.[11]

Courts of other jurisdictions have similarly heard the same "tort versus breach of contract" argument from insurers. A seminal case rejecting that dichotomy is *American Family Mut. Ins. Co v. American Girl, Inc.,* 673 N.W.2d 65, 77 (Wis. 2004), in which the Wisconsin Supreme provided guidance for subsequent cases, squarely holding that nothing in the CGL policy supports any definitive tort/contract line of demarcation and the word "tort" does not even appear in the CGL policy. In addition, in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1, 16 (Tex. 2007), the Texas Supreme Court held that the existence of an occurrence depends on whether the property damage is unexpected and unintended from the standpoint of the insured, and not whether the ultimate remedy is in contract or in tort.

There is simply no basis under the policy language to accept the argument that the coverage grant in a CGL policy only includes tort damages, and not breach of contract damages – especially where the breach that

[11] This Court further held that coverage applied only once the Qest plumbing leaked, that is, "at such time that a claimant suffers "physical injury to tangible property" in the form of water damage due to leaks from the Qest system." *Eljer Mfg., Inc.*, 197 Ill. 2d at 314. The townhome owners have certainly suffered that damage.

obligates the insured builder to repair or correct defective work on the home or project was unexpected or unintended. While all such damages may not eventually be covered, that determination must be made by careful consideration of the policy exclusions– exclusions that Acuity and the Insurer Amici have not even seriously addressed. Where defective work of subcontractors to the named insured is involved, the exclusions usually do not apply and a builder such as M/I Homes is entitled to coverage, including coverage for damage to its own work.

In terms of the purported "other property" requirement for property damage, Acuity would have this Court believe that property damage to the project itself constitutes uncovered breach of contract damages. But if the exact same type of property damage extends beyond the geographical boundaries of the project, it somehow morphs into covered tort damages. This position is nonsensical, especially considering the express terms of the Acuity policy. Such a principle does not survive further scrutiny in this appeal.

B. The Economic Loss Rule Does Not Affect CGL Coverage For Unexpected And Unintended Property Damage Arising Out of Defective Work

The flawed assumption of insurers such as Acuity that a CGL policy does not apply to property damage involving a breach of contract results in a confusing mishmash of concepts borrowed from substantive law, which adds nothing to the coverage analysis under a CGL policy. To boldly pronounce that all property damage arising out of the performance of defective work is natural,

ordinary and outside the realm of "occurrence" emasculates the policy language. The same is true with Acuity's argument that application of the economic loss rule thrusts unexpected and unintended property damage outside the definition of "occurrence". It does not, and this economic loss argument is yet another example of Acuity's effort to evade the language of its own policy.

Insurers have seized upon this argument from substantive products liability law for the proposition that when an injury is economic loss to the subject of a contract itself, the action sounds in contract alone. The consequence is that a tort action, usually one for negligence, is barred. As explained at page 23 of Acuity's own brief, where one part of an integrated product injures another part of that same product, even though the two components may have been supplied by different entities, the resultant loss to the plaintiff constitutes mere economic loss, compensable only in contract, and not "property damage," compensable in tort, citing *Trans State Airlines v. Pratt & Whitney Canada, Inc.*, 177 Ill. 2d 21, 50-51 (1997). The issue of whether a product has become "integrated" is determined by inquiring "[w]hat is the object of the contract or bargain that governs the rights of the parties?" *Trans State Airlines*, 177 Ill. 2d at 50.

Courts in other states have criticized and rejected the economic loss rule argument made by insurers such as Acuity. In *American Family Mut. Ins. Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004), an owner sought recovery

from a general contractor for damage to a warehouse resulting from settlement of the foundation which resulted in sinking, buckling, and cracking of the warehouse structure. The insurer characterized the claim as one for economic loss rather than property damage and argued that the economic loss doctrine barred coverage. The Wisconsin Supreme Court stated that there was no basis for the insurer's argument that a loss giving rise to a breach of contract or warranty claim categorically could never constitute "property damage" within the meaning of the CGL policy's coverage grant. The court determined that under the circumstances of an "occurrence" of physical injury to tangible property, the CGL insuring agreement provided coverage for the claim, a claim for "property damage" within the meaning of the policy. The court's analysis is worth quoting at length:

> The economic loss doctrine operates to restrict contracting parties to contract rather than tort remedies for recovery of economic losses associated with the special contract relationship… The economic loss doctrine is a remedies principle. It determines how a loss can be recovered – in tort or in contract/warranty law. It does not determine whether an insurance policy covers a claim, which depends instead upon the policy language.
>
> The economic loss doctrine may indeed preclude tort recovery here (the underlying claim is in arbitration not before us); regardless, everyone agrees that the loss remains actionable in contract, pursuant to specific warranties in the construction agreement between Pleasant [the owner] and Renschler [the insured contractor]. To the extent that American Family [the insurer] is arguing categorically that a loss giving rise to a breach of contract or warranty claim can *never* constitute 'property damage' within the meaning of the CGL's coverage grant, we disagree.
>
> *American Girl, Inc.*, 673 N.W.2d at 75.

A similar case is *Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 242 S.W.3d 1 (Tex. 2007), in which the Texas Supreme Court conducted an in-depth analysis of the economic loss doctrine as applied to a claim involving physical injury to a home arising out of soils preparation work of the builder's subcontractor. The court found that the economic loss rule is not a useful tool for determining insurance coverage. The rule generally precludes recovery in tort for economic losses resulting from the failure of a party to perform under a contract. Its focus is on determining whether the injury is to the subject of the contract itself. *Lamar Homes, Inc.*, 242 S.W.3d at 12. The court concluded that the rule is a liability defense or remedies doctrine, not a test for insurance coverage. *Id.* at 13. Winding up its analysis, the Texas Supreme Court set out its low opinion of the economic loss rule as follows:

> [I]nfatuation with the economic-loss rule as a policy-construction tool leads to the conclusion that "property damage" does not mean what the policy plainly says, but rather is code for tort damages. Texas law, however, requires that insurance policies be written in English, preferably plain English, not code.

Id. Likewise, the over-use of the term reduces the economic loss argument of Acuity, the Insurer Amici, to mere code, but under their code, "economic loss" equates to lack of damage to other property. This effort simply clouds the issue by calling the physical injury to the townhomes – water infiltration through the exterior – something else, i.e., economic loss.

Loose misapplication of the term "economic loss" also results in anomalous results under Illinois law as parties (and courts) seek to avoid the

wooden application of the other property/economic loss to otherwise covered claims under the policy. Extreme examples are *Westfield Ins. Co. v. Nat'l. Decorating Svc.,* 863 F.3d 690 (7th Cir. 2017), and *Acuity Ins. Co. v. 950 W. Huron Condo. Ass'n*, 2019 IL App (1st) 180743, both of which wrestled with the anomaly of applying different standards for coverage for subcontractors and general contractors under subcontractors' policies. This issue raised the concerns of Judge Mikva. It also concerns Illinois insureds.

III. CASE LAW OVERWHELMINGLY UPHOLDS COVERAGE FOR PROPERTY DAMAGE TO THE PROJRCT ARISING OUT OF DEFECTIVE WORK

Recognition by the courts that the CGL policy covers an insured contractor for property damage arising out of its subcontractor's defective work, or to otherwise non-defective portions of the work has not only been a trend in the law, but also has been a sea change. The highest courts of nearly every state, when faced with the issue of the scope of coverage for property damage under the 1986 CGL policy form, have upheld the existence of an occurrence under the circumstances of unexpected and unintended property damage to the project due to defective work. Such high courts have then gone on to properly apply property damage exclusions under the policies. The Amici Curiae provided briefs in support of many of the insured contractors and builders in those cases.

Three of the most influential of those cases have been addressed above. *American Family Mut. Ins. Co. v. American Girl, Inc.,* 673 N.W.2d 65 (Wisc.

2004) set out the broadening effect of the subcontractor exception to the Your Work Exclusion. The Wisconsin Supreme Court recognized that in 1986, the insurance industry extended coverage to property damage caused by the work of subcontractors by inserting the subcontractor exception to the "your work" exclusion. *American Girl, Inc.,* 673 N.W.2d at 82-83.

The Texas Supreme Court's opinion in *Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 242 S.W.3d 1 (Tex. 2007), followed, and heavily relied upon the 1986 insertion of the subcontractor exception into the policy to determine that the unexpected and unintended damage to the home project constituted an occurrence.

A third case of note is *Cypress Point Condo. Ass'n, Inc. v. Adria Towers, LLC*, 143 A.3d 273 (N.J. 2016), discussed and analyzed above due to the New Jersey Supreme Court's abrogation of the effect of the notoriously mistaken analysis of *Weedo v. Stone–E–Brick, Inc*., 405 A.2d 788, as applied to the 1986 policy form.

Mindful of the prohibition on stacking citations, a tally of the other state court and federal opinions that recognize the existence of an occurrence as to defective work of subcontractors or to otherwise non-defective portions of the work is nevertheless effective and includes:

Florida: *United States Fire Insurance Company v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007). Structural and interior damage to homes was an occurrence and the term "accident," while not otherwise defined, should

include not only accidental events but also injuries or damages that are neither expected nor intended from the standpoint of the insured, applying the subcontractor exception to the Your Work Exclusion to preserve coverage as to the subcontractor's defective work.

Michigan: *Skanska USA Building Inc. v. M.A.P. Mechanical Contractors, Inc.*, 952 N.W.2d 402 (Mich. 2020). The "business risk" distinction between damage to property of a third party and the insured's own work was based on an "outdated" rationale grounded in the language of the 1973 CGL policy. The 1986 CGL policy revisions underscored the fact that an insured's own faulty work could constitute an "occurrence"—even if later excluded from coverage via explicit exclusions.

South Dakota: *Owners Ins. Co. v. Tibke Construction, Inc.*, 901 N.W.2d 80 (S.D. 2017). Homeowners alleged an occurrence causing property damage that was covered by the general contractor's CGL policy and the subcontractor's failure to test the soil was not an intentional or deliberate action, but rather was an unplanned omission that caused an unexpected result.

Iowa: *National Sur. Corp. v. Westlake Investments, LLC*, 880 N.W.2d 724 (Iowa 2016). There was an occurrence where defective installation of building wrap and flashings resulted in water penetration that caused widespread damage to the interior components that were not defective.

Indiana: *Sheehan Constr. Co., Inc. v. Continental Cas. Co.,* 935 N.E.2d 160 (Ind. 2010). Unexpected and unintended property damage arising from the faulty workmanship of subcontractors to the insured is not foreseeable from the standpoint of the insured contractor, is an accident within the CGL policy, and constitutes an occurrence. The court supported its holding with the subcontractor exception to the your work exclusion, determining that it would serve no purpose if there was not an initial grant of coverage in the policy. Like many of these opinions, the decision changed and clarified inconsistent prior Indiana law.

Mississippi: *Architex Ass'n, Inc. v. Scottsdale Ins. Co.*, 27 So.3d 1148 (Miss. 2010). The only relevant question was whether the chain of events leading to the defective installation of rebar was set in motion and followed a course consciously devised and controlled by the insured without the unexpected intervention of a third person or extrinsic force. Therefore, the court found the term "occurrence" could not be construed in such a manner as to preclude coverage for unexpected and unintended property damage resulting from the negligent acts or conduct of a subcontractor.

Georgia: *American Empire Surplus Lines Ins. Co. v. Hathaway Dev. Co.*, 707 S.E.2d 369 (Ga. 2011). An occurrence can arise where faulty workmanship causes unforeseen or unexpected damage to other property. Therefore, the plumbing subcontractor's various acts of negligence that damaged other property besides its own work constituted an occurrence.

Kansas: *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.,* 137 P.3d 486 (Kan. 2006). The court found an occurrence where the faulty materials and workmanship provided by the insured's subcontractors caused continuous exposure of the home to moisture, which in turn, caused damage that was unforeseen and unintended.

North Dakota: *K&L Homes, Inc. v. American Family Mut. Ins. Co.,* 829 N.W.2d 724 (N.D. 2013). Faulty workmanship may constitute an occurrence if the faulty work was unexpected and unintended by the insured and the property damage was not anticipated or intentional. There is no basis within the "occurrence" definition to distinguish between damage to the insured's work and damage to some third party's property.

Connecticut: *Capstone Bldg. Corp. v. American Motorists Ins. Co.,* 67 A.3d 961 (Conn. 2013). Allegations of a subcontractor's unintended defective construction may constitute an occurrence if it damages non-defective work or property of third persons.

Minnesota: *Wanzek Constr., Inc. v. Employers Ins. of Wausau*, 679 N.W.2d 322 (Minn. 2004). The court rejected the applicability of the "business risk" doctrine to a claim under the 1986 form and upheld coverage under the subcontractor exception to the Your Work Exclusion.

West Virginia: *Cherrington v. Erie Ins. Prop. & Cas. Co.,* 745 S.E.2d 508 (W. Va. 2013). Defective work can constitute an occurrence if it was not intended or expected by the insured.

Montana: *Employers Mut. Cas. Co. v. Fisher Builders, Inc.*, 371 P.3d 375 (Mont. 2016). An "accident," and therefore, an "occurrence," may include an intentional act if the damages were not objectively intended or expected by the insured.

There are numerous opinions from federal courts of appeals and lower state appellate courts also upholding the existence of an occurrence as to defective work and that sort out claims based upon the 1986 property damage exclusions. The appellate court below cited to one of those cases, *Black & Veatch Corp. v. Aspen Ins. (UK) Ltd.*, 882 F.3d 952 (10th Cir. 2018), in expressing its comments as to continued adherence to the "other property." A similar case is *Greystone Construction, Inc. v. National Fire & Marine Insurance Co.*, 661 F.3d 1272 (10th Cir. 2011)(applying Colorado law, the only way the Your Work Exclusion and the subcontractor exception have effect is if physical injury caused by poor workmanship may be an occurrence under standard CGL policies).

While not from a state supreme court, one of the clearest judicial statements of the intent to provide this coverage is set out by the court in *O'Shaugnessy v. Smuckler Corp.*, 543 N.W.2d 99 (Minn. Ct. App. 1996), *review denied* (Minn. Mar. 28, 1996). In that case, the insured homebuilder constructed a home with all of the actual work being performed by subcontractors. Defects in the home surfaced after completion. In specifically

addressing the application of the subcontractor exception to the claim, the court stated as follows:

> Here, we are faced not with an omission, but an affirmative statement on the part of those who drafted the policy language, asserting that the exclusion does not apply to damages arising out of the work of a subcontractor. ***It would be willful and perverse for this court simply to ignore the exception that has now been added to the exclusion.*** [Emphasis added.]

Id. at 104. Likewise, it is willful and perverse for Acuity to ask this Court to ignore the same subcontractor provision in the Acuity policy.

In response to this significant precedent, Acuity asserts that the case law is "not unanimous" as to the upholding of coverage for an occurrence of unexpected and unintended property damage and the application of restrictive property damage exclusions that preserve coverage. But in support of its assertion, Acuity only manages citation to two cases from the same state, *Ohio Northern University v. Charles Construction Services, Inc.*, 120 N.E.3d 762 (Ohio 2020), and *Westfield Ins. Co. v. Custom Agri Sys., Inc.,* 979 N.E.2d 269 (Ohio 2012). Unfortunately, Ohio amounts to an outlier jurisdiction, and its courts' analysis of lack of fortuity as to subcontractor work and the need for damage to third party property flies in the face of the mountain of precedent from courts that apply the policy language.[12]

[12] Likewise, Insurer Amici cite to a number of foreign cases for the proposition that a breach of contract cannot give rise to an occurrence. None of those cases provide support for that sweeping proposition: *Action Ads, Inc. v. Great Am. Ins. Co.*, 685 P.2d 42 (Wyo. 1984)(case involved no property damage, just a failure to procure medical insurance for the insured's employee); *City of Burlington v. Nat'l Union Fire Ins. Co.*, 655 A.2d 719, 722–23 (Vt. 1994) (no occurrence or property damage when City was sued for failing to purchase agreed upon amount of wood chips); *Accord Redevelopment Auth. of Cambria Cnty. V. Int'l Ins. Co.*, 685 A.2d 581

IV. THE SUBCONTRACTOR EXCEPTION TO THE YOUR WORK EXCLUSION PRESERVES EXISTING COVERAGE UNDER THE CGL POLICY

Acuity and the Insurer Amici argue that applying the subcontractor exception in this case amounts to an impermissible creation of coverage by an exclusion. It is nothing of the kind. This line of argument by Acuity and the Insurer Amici is based on the false assumption that defective workmanship can never give rise to an "occurrence" of property damage, and thus, can never be within the initial coverage grant of the CGL policy. This position, however, is contrary to the definitions in the policy, as well as the carefully crafted property damage exclusions. Such exclusions would serve little purpose if the coverage grant did not include the type of damages that are sought against builders such as M/I Homes.

This same ineffectual argument was made by the insurer and rejected in *American Family Mutual v. American Girl, supra,* 673 N.W.2d at 83-84:

> This interpretation of the subcontractor exception to the business risk exclusion does not 'create coverage' where none existed before, as American Family contends. There is coverage under the insuring agreement's initial coverage grant. Coverage would be excluded by the business risk exclusionary language, except that the subcontractor exception to the business risk exclusion

(Pa. Super. Ct. 1996) (action against insured redevelopment authority for failure to deliver potable water and to meet environmental standard to a township; another actual breach of contract with no property damage); *ACS Constr. Co. of Miss. v. CGU*, 332 F.3d 885, 889–91 (5th Cir. 2003)(abrogated by the Mississippi Supreme Court in *Architex Ass'n, Inc. v. Scottsdale Ins. Co.,* 27 So. 3d 1148, referring to the reasoning of *ACS* as "incongruous"); *Am. Mfrs. Mut. Ins. Co. v. Seco/Warwick Corp.*, 266 F. Supp. 2d 1259 (D. Colo. 2003)(failure of insured's furnaces to perform to contract specifications, did not constitute "occurrence;" no property damage).

applies, which operates to restore the otherwise excluded coverage.

Curiously, Insurer Amici quote from *United States Fire Insurance Company v. J.S.U.B., Inc.*, 979 So.2d 871, 877, that "exclusionary clauses cannot be relied upon to create coverage." However, they disingenuously omit that the Florida Supreme Court applied that concept to hold the subcontractor exception did not create coverage but preserved the coverage available to the insured general contractor for the defective work of its subcontractors.

All the authorities relied upon by Acuity and the Insurer Amici are inapposite in light of their misunderstanding of, or willingness to ignore the satisfaction of the occurrence and property damage requirement of the CGL insuring agreement. This Court should also reject this argument and adopt the reasoning of the myriad of jurisdictions that have similarly done so.

V. A CGL POLICY IS NOT CONVERTED TO A PERFORMANCE BOND BY ADHERING TO THE POLICY LANGUAGE

Acuity and the Insurer Amici insist that upholding coverage for defective workmanship claims such as the one before this Court will magically, but impermissibly transform the insurance policy into a performance bond. Applying the policy language will do nothing of the sort, and this false analogy is a true red herring intended by Acuity to divert the attention of this Court away from the terms of the policy. To accept the performance bond argument, this Court would have to forsake the ordinary meaning of the language of the policy before it. This argument, though easier to state than to justify, is divorced from the realities of a modern construction project. Once again, in

making this argument, Acuity demonstrates its willingness to thumb its nose at the workings of the construction industry it claims to insure.

A. An Insurance Policy Spreads The Contractor's Risk While A Bond Financially Guarantees Its Performance

A performance bond is not insurance. The insurance policy is a contract of indemnity, while a surety bond is a guaranty of the performance of the principal's obligations. An insurance policy is issued based on an evaluation of risks and losses that is actuarially linked to premiums. In other words, losses are expected. In contrast, a surety bond is underwritten based on what amounts to a credit evaluation of the contractor and its capabilities to perform its contracts, with the expectation that no losses will occur. Sureties usually maintain close relationships with their contractor-principals as well as the contractor's bank, accountants and attorneys. As part of the underwriting of bonds, the surety analyzes the strengths and weaknesses of the contractor and its ability to perform its obligations. In short, the underwriting process is very similar to the process used by a lender in making a loan. In contrast to insurance, losses are not expected. In addition, the performance bond is not for the protection of the contractor, but rather for the protection of the owner (the "obligee").[13] If the contractor fails to complete its construction contract, the surety may satisfy its obligation to the obligee under the bond by providing additional financing so that the original contractor can complete the work, or

[13] For the sake of simplicity, this argument will use terminology from bonds issued to general contractors in favor of the owner. It also applies to subcontract bonds, issued in favor of a subcontractor to a general contractor.

by finding another contractor to complete the construction, or finally, by having the obligee complete the job itself, with the surety paying the extra costs.

The performance bond is a three-party instrument between the "obligee" (usually the owner), the surety, and the contractor, with the surety retaining a right of indemnity against the contractor as well as other third-party indemnitors, typically the individual owners of a construction company. In the event of a claim, the surety will invoke the indemnity agreement with its principal (the contractor) and the indemnitors to hold it harmless and often to defend it against the claim. Thus, the contractor will, in effect, be required to pay the loss from its own funds when it indemnifies the surety. Of course, an insurance company has no right of indemnity against its insured, although it may seek to recover its losses from third parties through subrogation. Also, it is the liability insurer that bears the duty to defend claims alleged against its insured contractor if those claims arguably are covered under the policy. A surety owes no defense obligation to either its principal or the obligee.

Courts have recognized the profound differences between performance bonds and liability insurance. One of those cases rejecting the comparison is *Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 242 S.W.3d 1, in which the insured homebuilder sought coverage for property damage to a home arising out of the defective foundation work of its subcontractor. One of the many arguments raised by the insurer in addition to the "defective work as not an occurrence" was that to uphold coverage would be to convert the CGL policy

into a performance bond. The court rejected this argument out of hand, concluding that any similarities between CGL insurance coverage and a performance bond under the circumstances of a subcontractor defect claim were "irrelevant." It also noted that "the CGL policy covers what it covers. No rule of construction operates to eliminate coverage simply because similar protection may be available through another insurance product." *Id.* at 10.[14] This same result, rejecting the "CGL as performance bond" argument was reached by nearly all of the courts set out in Section III of this brief in the context of upholding the existence of an occurrence under the facts and circumstances before them.

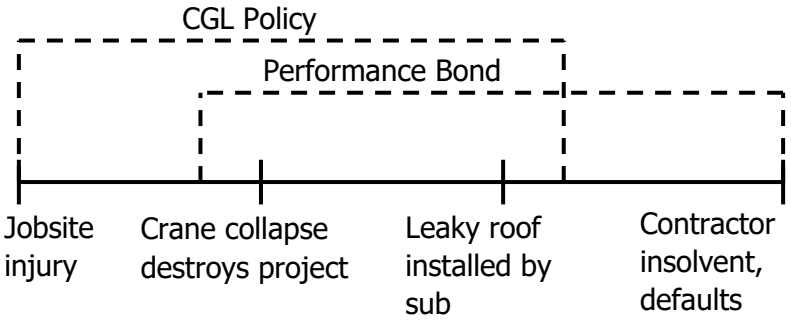
B. Liability Insurance and Performance Bonds May Converge In Defective Construction Claims

Some claims, particularly claims that involve defective workmanship that cause damage to the project, can trigger ***both*** the CGL policy and the performance bond. In that instance, the CGL policy should respond, particularly considering the contractor's indemnity obligations to the surety. Upon payment to the owner of a performance bond claim involving defective workmanship, the contractor's rights under its CGL policy are frequently assigned to the surety for pursuit of subrogation. For cases illustrating the scenario of a performance bond surety having paid a claim, and then pursuing coverage for defective workmanship from its principal's CGL insurer, *see,*

[14] For a case reaching the same conclusion and involving both a surety and a performance bond surety, *see Fidelity & Deposit Co. of Maryland v. Hartford Cas. Ins. Co.,* 189 F.Supp.2d 1212 (D. Kan. 2002).

Fidelity & Deposit Co. of Maryland v. Hartford Cas. Ins. Co, 189 F.Supp.2d 1212; *Standard Fire Ins. Co. v. Chester-O'Donnelly & Assoc., Inc.,* 972 S.W.2d 1 (Tenn. App. 1998)(upholding recovery by surety from CGL insurer for damage arising out of principal's defective work).

The fallacy behind Acuity's argument is that the scope of "coverage" of a performance bond and CGL policy must be mutually exclusive. While it is true that there are many types of risks and losses that fall within the ambit of a bond and not an insurance policy, and vice vesa, there remains a considerable overlap between the two. This is particularly true, where, as in the case of defective work, a breach of the bonded contract may be involved. In that connection, the following diagram can be considered:



This diagram illustrates a continuum of job-site risks. Along that continuum, at the left are pure CGL policy losses, i.e., bodily injuries, and moving farthest to the right, a performance default by the contractor, a pure performance bond loss. Superimposed on that continuum is the scope of coverage provided by a CGL policy and a performance bond, signified by the dotted lines. As can be

seen, there is an overlap in the middle. Starting at the left, assume that an accident at the job site seriously injures the employee of a subcontractor to the insured. In the event the insured contractor is sued by that employee, the contractor's CGL policy would respond to this claim. The performance bond is not implicated by the bodily injury. Next, assume a subcontractor's crane collapses, causing damage to major portions of the project. Absent a waiver of subrogation, the contractor's CGL policy may be required to respond to that loss. At the same time, the collapse and the attendant damage may constitute a breach of the general contractor's bonded contract, falling within the bonded obligation of the contractor, and thus the performance bond. Much the same can be said for a leaky roof installed by the roofing subcontractor on a project. Again, the contractor's CGL policy should respond to claims for property damage, even for the cost of repairing the roof itself based upon the subcontractor exception in the Your Work Exclusion. Likewise, the roofing failure will constitute a breach of the bonded contract, thus implicating the performance bond. Finally, at the far right of the continuum is a classic default by the bonded contractor caused by insolvency. Such a default is a performance bond matter that should not impact liability coverage for the contractor as an insured. *Eljer* illustrates another type of default giving rise to a performance bond claim: the installation of the defective Quest plumbing systems that were defective, but had not yet failed. *See Eljer Mfg., Inc.*, 197 Ill. 2d 278. There was

no property damage for purposes of CGL coverage and hence the Court's fleeting reference to performance bonds.

Thus, the diagram demonstrates that many claims, particularly defective work claims, may have a potential impact on both the performance bond and the CGL policy. It may be difficult to separate the two from each other where there is a breach of contract involving the work. In *Kalchthaler v. Keller Constr. Co.*, 591 N.W.2d 169 (Wis. Ct. App. 1999), the court recognized this overlap applying the subcontractor exception to uphold coverage for claims against a general contractor for water damage to the interior of new construction caused by faulty window installation by a subcontractor. In the course of doing so, it stated as follows:

> For whatever reason, the [insurance] industry chose to add the new exception to the business risk exclusion in 1986. We may not ignore that language when interpreting case law decided before and after the addition. To do so would render the new language superfluous. [Citation omitted.] …
>
> We have not made the policy closer to a performance bond for general contractors, the insurance industry has.

Kalchthaler, 591 N.W.2d at 174. Once again, in reaching its conclusion, the court concentrated on the language of the policy before it and not the insurer's overly simple argument that to grant coverage would "turn the CGL policy into a performance bond."

Acuity gets no mileage out of its "CGL as performance bond" argument. As previously stated, the installation of defective work by a contractor that results in property damage to the project can also involve a default by that

contractor under the performance bond. When that occurs, and a surety takes over or finances the completion of the project, it turns its attention to recouping its loss from other parties, including the insured contractor. If the claim involves defective work in breach of the bonded contract and an "occurrence" of property damage that is not subject to exclusion under the CGL policy, particularly the property damage exclusions, the surety may seek recovery as an assignee of the insured contractor, or simply under a theory of equitable subrogation. Ironically, if this case involved a public or a larger project for which the contractor was bonded, it is possible that Acuity would be facing a subrogation claim by the performance bond surety. The irony of such a result is apparently lost on Acuity.

CONCLUSION

While this Court should affirm the First District Appellate Court's Judgment, it should also take this opportunity to clarify Illinois law as to CGL insurance coverage available to insured contractors and builders for property damage to a project that is unexpected and unintended, i.e., an accident, under the express terms of the Acuity CGL policy. Moreover, it should further clarify that coverage determinations as to CGL coverage available for property damage arising out of defective workmanship should be resolved through proper application of the entire policy, including the property damage exclusions that preserve coverage for Illinois insureds.

Dated: April 20, 2023

Respectfully Submitted,

/s/ Patrick J. Wielinski

Patrick J. Wielinski
COKINOS | YOUNG
One Galleria Tower
13355 Noel Road, Suite 1375
Dallas, TX 75240
Telephone: 817-635-3620
Email: pwielinski@cokinoslaw.com

Clifford J. Shapiro
SHAPIRO DISPUTE RESOLUTION LLC
615 Elmwood Ave.
Wilmette, IL 60091
Telephone: 847-207-2509
Email: clifford@shapiroadr.com

Attorneys for Amici Curiae

CERTIFICATE OF COMPLIANCE

I certify that this brief conforms to the requirements of the Illinois Supreme Court Rules 341(a) and (b). The length of this brief, excluding the pages or words contained in the Rule 341(d) cover, the Rule 341(h)(1) table of contents and statement of points and authorities, the Rule 341(c) certificate of compliance, the certificate of service, and those matters to be appended to the brief under Rule 342(a) is 13113 words.

/s/ Patrick J. Wielinski
Patrick J. Wielinski

NOTICE OF FILING AND PROOF OF SERVICE

The undersigned, being first duly sworn, deposes and states that on April 20, 2023, there was electronically filed and served upon the Clerk of Court the *Amicus Curiae* Brief of the Associated General Contractors of America, ACG of Illinois, Central Illinois Builders of AGC of America, Chicagoland AGC, Northern Illinois Building Contractors Association, Southern Illinois Builders Association, American Subcontractors Association, National Association of Home Builders, and Home Builders Association of Illinois. On April 20, 2023, service of the *Amicus Curiae* Brief will be accomplished by email, as well as electronically through the filing manager, Odyssey EfileIL, to the following counsel of record:

Joseph P. Postel
LINDSAY, PICKETT & POSTEL, LLC
200 West Madison Street, Suite 3850
Chicago, Illinois 60606
(312) 800-6008
jpostel@lpplawfirm.com

Glenn L. Fencl
Garrett L Boehm, Jr.
JOHNSON & BELL, LTD.
33 West Monroe Street, Suite 2700
Chicago, Illinois 60603
(312) 372-0770
fenclg@jbltd.com
boehmg@jbltd.com

Mark D. Brookstein
Alison L. Constantine
Patrick Johnson
Eric P. Sparks
GOULD & RATNER LLP
222 North LaSalle Street, Suite 300
Chicago, IL 60601
(312) 236-3003
mbrookstein@gouldratner.com
aconstantine@gouldratner.com
pjohnson@gouldratner.com
esparks@gouldratner.com

Jeffrey S. Youngerman
Christopher L. Gallinari
Stephen D. Sharp
FLAHERTY & YOUNGERMAN, P.C.
600 W. Van Buren Street, Suite 700
Chicago, IL 60607
(312) 782-4700
ssharp@fylegal.com
cgallinari@fylegal.com
jyoungerman@fylegal.com

Rachel A. Jankowski
Laura Foggan
CROWELL & MORNING LLP
1001 Pennsylvania Avenue, N.W.
Washington, DC 20004
(202) 624-2500
rjankowski@crowell.com
lfoggan@crowell.com

Within five days of acceptance by the Court, the undersigned states that 13 paper copies of the Brief bearing the court's file-stamp will be sent to the above court.

/s/ Patrick J. Wielinski
Patrick J. Wielinski

Under penalties as provided by law pursuant to Section 1-109 of Code of Civil Procedure, the undersigned certifies that the statements set forth in this instrument are true and correct.

/s/ Patrick J. Wielinski
Patrick J. Wielinski