NO. 122022

IN THE SUPREME COURT OF ILLINOIS

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| SIENNA COURT CONDOMINIUM ASSOCIATION, an Illinois not-for-profit corporation,<br><br>*Plaintiff-Appellee,*<br><br>*v.*<br><br>ROSZAK/ADC, LLC,<br><br>*Defendant/Counterplaintiff,*<br><br>*and*<br><br>DON STOLTZNER MASON CONTRACTOR, et al,<br><br>*Defendants/Counterdefendants-Appellants,*<br><br>*and*<br><br>CHAMPION ALUMINUM CORP., et al,<br><br>*Defendants/Counterdefendants.* | Appeal from the Appellate Court of Illinois for the First Judicial District No. 1-14-3364, 14-3687 and 1-14-3753 (consolidated)<br><br>There Heard on Appeal from the Circuit Court for Cook County, Illinois<br><br>No.: 13 L 002053<br><br>The Honorable **Margaret Brennan,** Judge Presiding. |

# APPELLANTS' REPLY BRIEF


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ORAL ARGUMENT REQUESTED

## POINTS AND AUTHORITIES

## ARGUMENT

### I. Plaintiff's answer to the petition for leave to appeal may not be incorporated by reference.

In a footnote, plaintiff Sienna Court Condominium Association improperly purports to "incorporate[] its Response to the Petition for Leave to Appeal."(Pl. Br. at 10, n.2.)

This Court "is 'entitled to have issues clearly defined with pertinent authority cited and cohesive arguments presented.'" *Bartlow v. Costigan*, 2014 IL 115152, ¶ 52, quoting *Velocity Investments, LLC v. Alston*, 397 Ill. App. 3d 296, 297 (2d Dist. 2010). Thus, an appellee's *brief* must contain the appellee's "contentions" along with "the reasons therefor." *Vancura v. Katris*, 238 Ill. 2d 352, 369–70 (2010); Ill. S. Ct. R. 341(h)(7). A footnote purporting to "incorporate" arguments made elsewhere does not suffice. *Id.*, citing *People v. Guest*, 166 Ill. 2d 381, 413-14 (1995). This Court should confine its review to those arguments contained in the parties' briefs.

### II. The *Minton* rule should be overruled.

In the 35 years since *Minton v. Richards*, 116 Ill. App. 3d 852 (1st Dist. 1983) was decided, plaintiff argues, the *Minton* rule has never been overruled. (Pl. Br. at 15.) But just two years after *Minton* was decided, the Fourth District squarely rejected it, reasoning: "If a subcontractor impliedly warrants his work to the purchaser..., then his liability should be independent of the builder's solvency." *Lehmann v. Arnold*, 137 Ill. App. 3d 412, 418 (4th Dist. 1985). A decade later, the Second District likewise rejected *Minton*, finding

that *Lehman* was right to question "whether, under *Redarowicz* [*v. Ohlendorf*, 92 Ill. 2d 171 (1982)], the builder's later solvency was relevant to whether the subcontractor originally made an implied warranty to the purchaser." *Bernot v. Primus Corp.*, 278 Ill. App. 3d 751, 754 (2d Dist. 1996). *Lehman* and *Bernot*, like *Minton*, have never been overruled.

Plaintiff glosses over *Lehman* and *Bernot*, suggesting those courts rejected *Minton* solely because the defendants there were sellers of unimproved land, not subcontractors involved in the physical aspects of construction. But the *Lehman* and *Bernot* decisions did not turn on any distinction between subcontractors and sellers of land. Rather, in rejecting the *Minton* rule, both *Lehman* and *Bernot* expressly rejected the premise at the heart of *Minton*: that a subcontractor's obligations could be triggered by a builder's later insolvency. *Id.* at 754–55; *Lehman*, 137 Ill. App. 3d at 418.

*Bernot* emphasized that an implied warranty of habitability claim is an action for the recovery of economic loss—a recognition that reveals why recovery premised on tort law concepts of "relative culpability" is impermissible. The duties imposed by the implied warranty of habitability arise by virtue of the sales contract. Just as those duties may not be imposed on architects, design professionals, and material suppliers who are not party to the sales contract (see A23–26), they should likewise not be imposed on subcontractors. *Board of Managers of Park Point at Wheeling Condominium Ass'n v. Park Point at Wheeling, LLC*, 2015 IL App (1st) 123452, ¶ 15

("generally speaking, only builders or builder-sellers warrant the habitability of their construction work").

### A. The duties imposed by the implied warranty of habitability are rooted in the sales contract.

The concept of implied warranty "has been labeled 'a freak hybrid born of the illicit intercourse of tort and contract.'" Lindsey, E., *Strict Liability And The Building Industry*, 33 Emory L.J. 175, 203 (1984), quoting Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 Minn. L. Rev. 791, 800 (1966). See *Szajna v. General Motors Corp.*, 115 Ill. 2d 294, 304 (1986) (the term "implied warranty" has "unfortunately and inaccurately... been used to describe obligations... totally unrelated to any contractual relationship" as well as "to describe obligations implied because of a privity relationship between contracting parties").

In some states "the implied warranty of habitability is grounded in tort as a type of strict liability." Locke, P. and Elliott, P., *Caveat Broker: What Can Real Estate Licensees Do About Their Potentially Expanding Liability for Failure to Disclose Radon Risks in Home Purchase and Sale Transactions?*, 25 Colum. J. Envtl. L. 71, 98 (2000). Believing incorrectly that Illinois follows this approach, plaintiff characterizes *Minton* as "analogous to a strict liability tort claim where privity is not necessary to measure the scope of one's relative liability." (Pl. Br. at 26.)

In other states, "the implied warranty of habitability arises in contract as an extension of the home sales contract." *Id.* Illinois follows this approach, recognizing that an implied warranty of habitability in the sale of a new home "arises by virtue of the execution of the agreement between the vendor and the vendee." *Petersen v. Hubschman Const. Co.*, 76 Ill. 2d 31, 41 (1979).

In *Redarowicz*, recognizing that the implied warranty "is a creature of public policy," this Court allowed subsequent purchasers to enforce the implied warranty despite a lack of contractual privity. But this Court expressly reaffirmed the warranty's "roots in the execution of the contract for sale." *Redarowicz*, 92 Ill. 2d at 183. *Redarowicz*, this Court explained, permits a subsequent purchaser to enforce the implied warranty because the builder-vendor in that situation "is held to nothing more than those obligations *that arose from its original contract* with the first purchaser." (Emphasis added.) *Fattah v. Bim*, 2016 IL 119365, ¶ 26.

Allowing subsequent purchasers to enforce the implied warranty effectively recognizes an implied assignment of a first buyer's warranty rights (see *Redarowicz*, 92 Ill. 2d at 184–85), with subsequent purchasers "merely stepping into the shoes of the first" (*Fattah*, 2016 IL 119365 at ¶ 34). *Redarowicz* "expanded the class of possible *plaintiffs* who can bring an implied warranty action," but *Redarowicz* "does not suggest the class of possible *defendants* should be expanded" to impose obligations on entities not party to the underlying sales contract. *Lehman*, 137 Ill. App. 3d at 417.

Plaintiff claims the implied warranty should be expanded to subcontractors because "courts and legislatures have eroded the traditional notions of privity as a barrier to recovery." (Pl. Br. at 19.) But, like *Redarowicz,* the cases plaintiff cites expand only the class of possible plaintiffs permitted to bring a particular action, not the class of defendants upon whom duties are imposed. For example, in *Pelham v. Griesheimer*, 92 Ill. 2d 13, 23 (1982), this Court held that an attorney's duties arising out of an attorney-client relationship could be extended to non-clients where the non-client is an intended third-party beneficiary of that relationship. Similarly, the California Supreme Court held that the intended beneficiary of a defective will could, despite a lack of privity, pursue a claim against the notary who prepared the will improperly. *Biakanja v. Irving*, 320 P.2d 16, 19 (Cal. 1958). See also *MacPherson v. Buick Motor Co.*, 111 N.E. 1050, 1053 (N.Y. 1916) (duty owed by manufacturer in product liability action not limited to immediate purchaser).

The relaxation of privity requirements to expand the class of *plaintiffs* who can bring certain actions does not mean this Court should expand the class of *defendants* upon whom duties arising from contract are imposed.

### B. Severing the implied warranty of habitability from its contractual roots would conflict with the economic loss doctrine.

Despite holding that "[p]rivity of contract is not required" for a subsequent purchaser to enforce the implied warranty of habitability against a

builder-vendor, this Court nevertheless reaffirmed the warranty's "roots in the execution of the contract" and never suggested that the duties arising from that contract could be delegated to non-contracting parties. *Redarowicz*, 92 Ill. 2d at 183. Any attempt to untether the duties imposed by the implied warranty of habitability from their origin in the sales contract would collide with the *Moorman* doctrine, which bars recovery in tort for purely economic loss. See *Moorman Manufacturing Co. v. National Tank Co.*, 91 Ill. 2d 69, 91 (1982).

"A duty to use ordinary care and skill is not imposed in the abstract," but instead "results from a conclusion that an interest entitled to protection will be damaged if such care is not exercised." *Redarowicz*, 92 Ill. 2d at 177, quoting *Crowder v. Vandendeale*, 564 S.W.2d 879, 882 (Mo. 1978). "A buyer's desire to enjoy the benefit of his bargain is not an interest that tort law traditionally protects." *Id.*, citing Prosser, Torts sec. 92, at 613 (4th ed. 1971). See also *East River Steamship Corp. v. Transamerica Delaval*, 476 U.S. 858, 871 (1986) ("When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong.")

The economic loss rule "reflects the distinction between tort and contract." *2314 Lincoln Park West Condominium Ass'n v. Mann, Gin, Ebel & Frazier, Ltd.*, 136 Ill. 2d 302, 309 (1990). The "concept of duty" lies "at the heart of [this] distinction." *Id.* at 314. This Court explained:

> "The [economic loss] rule acts as a shorthand means of determining whether a plaintiff is suing for injuries arising from the breach of a contractual duty to produce a product that conforms in terms of quality or performance to the parties[']expectations or whether the plaintiff seeks to recover for injuries resulting from the breach of the duty arising independently of the contract to produce a nonhazardous product that does not pose an unreasonable risk of injury to person or property."

*Id.* at 315–16, quoting *Flintkote Co. v. Dravo Corp.*, 678 F.2d 942, 948 (11th Cir. 1982). Implied warranty of habitability claims address injuries arising from alleged defects in quality, not defects creating an unreasonable risk of injury to person or property.

"[C]laim[s] concern[ing] the quality, rather than the safety, of [a] building [are]... more appropriately resolved under contract law." *2314 Lincoln Park West Condominium Ass'n*, 136 Ill. 2d. at 317. Thus, this Court has confirmed repeatedly that "latent construction defects, resulting in solely economic loss, are not recoverable under a negligence theory." *Foxcroft Townhome Owners Association v. Hoffman Rosner Corp.*, 96 Ill. 2d 150, 156 (1983). Accord *Morrow v. L.A. Goldschmidt Associates, Inc.*, 112 Ill. 2d 87, 98 (1986); *Redarowicz*, 92 Ill. 2d at 178.

Claims for breach of the implied warranty of habitability are not barred by the economic loss doctrine precisely because these claims are premised on duties arising from a sales contract, not duties arising under tort law. The *Redarowicz* court implicitly confirmed this point, holding that the economic

loss doctrine barred the plaintiffs' negligence claims while their implied warranty claims could proceed. See *Fattah*, 2016 IL 119365 at ¶¶ 24–25.

Because "contracting parties are free to bargain over the terms of their warranties," the economic loss rule "limit[s] the potentially far-reaching consequences that might otherwise result from imposing tort liability for disappointed commercial or consumer expectations." *2314 Lincoln Park West Condominium Ass'n*, at 308. Thus, in recognizing the existence of an implied warranty in the sale of a new home, this Court also recognized that "provisions in a contract disclaiming the existence of such an implied warranty" are not contrary to public policy. *Petersen*, 76 Ill. 2d at 43.

This same interest in protecting contracting parties' ability to bargain over the terms of their warranties underscored this Court's refusal in *Fattah* to extend the implied warranty of habitability to a subsequent purchaser in the face of a disclaimer by the first. *Fattah*, 2016 IL 119365 at ¶¶ 29–34. In contracting with a new-home purchaser, a builder-vendor is able to "obtain a date certain on which the builder-vendor's exposure to financial risk relating to the house will end" by negotiating a "bargained-for waiver of the implied warranty of habitability" in exchange for "a reduction in the price of the house or... some other consideration, such as an express warranty." *Id.* at ¶ 29. Because a subsequent purchaser "merely step[s] into the shoes of the first," allowing a subsequent purchaser to assert the implied warranty despite a

bargained-for waiver would deprive the builder-vendor of the benefit of its bargain. *Id.* at ¶¶ 30, 34.

The *Minton* rule undermines the very freedom to bargain that the economic loss doctrine is designed to protect. Unlike the builder-vendor, a subcontractor is not party to the sales contract and has no opportunity to negotiate a waiver of the implied warranty of habitability. And, at least in the First District, a subcontractor does not enjoy the benefit of a valid waiver negotiated in favor of the builder-vendor. *1324 W. Pratt Condominium Ass'n v. Platt Const. Group, Inc.*, 2012 IL App (1st) 111474, ¶¶32–33.

Subcontractors contract with the builder-vendor or a general contractor. The subcontract in this case limits the subcontractors' liability for injuries to third parties (like plaintiff) to claims "attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself)." (C3538.) Because no implied warranty of habitability arises from a contract between subcontractors and builder-vendors, these subcontracts provide no occasion for negotiating a waiver of the implied warranty of habitability.

Plaintiff attempts to justify *Minton's* expansion of liability to subcontractors by analogizing the implied warranty to a strict liability tort claim. (Pl. Br. at 26.) Recognizing that subcontractors' duties cannot arise from a sales contract to which they were not party, plaintiff urges this Court to instead approve the *Minton* rule based on tort law concepts of "relative

culpability." (Pl. Br. at 26–27.) But in arguing that "there is no reason why the implied warranty should not be... applied against a subcontractor in the same way a tort claim is applied against a component part supplier" in a product liability case, plaintiff overlooks *Moorman*.

In *Moorman*, this Court specifically held that a "plaintiff cannot recover for solely economic loss under the tort theories of strict liability, negligence and innocent misrepresentation." *Moorman*, 91 Ill. 2d at 91. A claim against subcontractors grounded in a strict liability tort theory thus fares no better than the negligence claims that this Court held were barred in *Redarowicz*.

To date, this Court has recognized only three exceptions to the *Moorman* doctrine, none of which apply here:

> (1) where the plaintiff sustained damage, *i.e.*, personal injury or property damage, resulting from a sudden or dangerous occurrence...; (2) where the plaintiff's damages are proximately caused by a defendant's intentional, false representation, *i.e.*, fraud...; and (3) where the plaintiff's damages are proximately caused by a negligent misrepresentation by a defendant in the business of supplying information for the guidance of others in their business transactions...

(Citations omitted.) *First Midwest Bank, N.A. v. Stewart Title Guaranty Co.*, 218 Ill. 2d 326, 337 (2006). Expanding the implied warranty of habitability to subcontractors based on a tort theory of strict liability would require this Court to create a fourth exception to the *Moorman* doctrine: where the plaintiff's damages arise from latent defects in the construction of a new home. This Court did not adopt such an exception to permit tort claims against the

builder-vendor in *Redarowicz*, and it should not adopt such an exception to permit tort claims against the subcontractors here.

The applicability of *Moorman*, moreover, does not depend on the existence of a contractual remedy against the subcontractors: a "plaintiff seeking to recover purely economic losses due to defeated expectations of a commercial bargain cannot recover in tort, regardless of the plaintiff's inability to recover under an action in contract." *Anderson Electric, Inc. v. Ledbetter Erection Corp.*, 115 Ill. 2d 146, 153 (1986).

### C. Plaintiff's reliance on statutory enactments is misplaced.

Plaintiff contends two statutes—Illinois' Mechanics Lien Act (770 ILCS 60/0.01, *et seq.*) and Connecticut's New Home Warranties Act (Conn. Gen. Stat. § 47-116, *et seq.*)—support expanding liability under the implied warranty of habitability to subcontractors. Plaintiff does not explain why isolated legislative choices made by this or another state's lawmakers should guide this Court's development of Illinois common law. If, in fact, these statutes demonstrated legislative support for *Minton*'s expansion of implied warranty liability, then logically plaintiff should lobby Illinois' legislature, not this Court, to adopt that expansion in Illinois. Neither statute, however, supports plaintiff's argument.

### 1. Unlike *Minton*, the Mechanics Lien Act seeks to preserve rather than expand the parties' contractual rights and duties.

Plaintiff decries the Subcontractors' "galling hypocrisy" in arguing that the implied warranty of habitability does not apply to parties not involved in the sale of a new home when they enjoy the statutory benefit of a mechanic's lien even in the absence of any direct contractual relationship with a new home buyer. (Pl. Br. at 20–21.) Plaintiff fails to appreciate, it seems, the Illinois legislature's careful allocation of the benefits and risks arising under the contracts among contractors, subcontractors, and property owners.

The Mechanics Lien Act creates a carefully structured system designed to protect the contractual expectations of contractors, subcontractors, and property owners alike. First, to insure that contractors who provide valuable improvements to property are not left empty-handed by a non-paying property owner, the Mechanics Lien Act grants contractors a lien on the property for the value of their labor. 770 ILCS 60/1(a). This right is conditioned on the existence of a contract between the contractor and property owner. *Id.*

Recognizing that a contractor's labor is often delegated to subcontractors, the Mechanics Lien Act also provides subcontractors an independent lien both on the property "and on the moneys or other considerations due or to become due from the owner under the original contract" with the contractor. 770 ILCS 60/21(a). To perfect this lien, the subcontractor must, within 60 days of commencing work, warn the property

owner that it should not make payment to the contractor without first receiving a waiver of each subcontractor's lien. 770 ILCS 60/21(c). The subcontractor's lien is preserved "only to the extent that the owner has not been prejudiced by payments made prior to receipt of the notice." *Id.*

A subcontractor's lien under the Mechanics Lien Act operates like an assignment of the contractor's rights under its contract with the property owner, just as a subsequent purchaser's ability to enforce the implied warranty under *Redarowicz* operates like an assignment of an initial purchaser's warranty rights. And like the expansion on the implied warranty in *Redarowicz*, the rights created by the Mechanics Lien Act do not impose obligations on a property owner beyond those obligations the property owner already agreed to in its underlying contract with the general contractor. So long as the property owner heeds the subcontractor's warning not to make payments to the contractor without first receiving a waiver of liens, the owner will not be liable for more than the amount it agreed to pay in its contract with the contractor. 770 ILCS 60/21(d).

The *Minton* rule is different. Instead of recognizing an *assignment of rights* under an existing contract, the *Minton* rule seeks to compel a *delegation of duties* under an existing contract. See *Olson v. Etheridge*, 177 Ill. 2d 396, 406 (1997), quoting *In re Marriage of LaShelle*, 213 Ill. App. 3d 730, 735 (2d Dist. 1991) ("Rights are assigned; duties are delegated.") The *Minton* rule does not limit a subcontractor's liability to the obligations it agreed to in its

contract with the builder- or developer-vendor, but seeks to impose obligations unrelated to the subcontractor's own contract. Plaintiff cites no authority in which this Court delegated duties arising out of a sales contract to an entity that is not a party (or in privity with a party) to that contract. The rights that the Illinois legislature chose to provide in the Mechanic's Lien Act do not support the *Minton* court's expansion of the implied warranty to subcontractors.

### 2. Connecticut's New Home Warranties Act does not embrace the *Minton* rule.

Plaintiff additionally urges approval of the *Minton* rule based on a section of Connecticut's New Home Warranties Act, which provides that "issuance... of a certificate of occupancy for any newly constructed single-family dwelling" carries with it an implied warranty from subcontractors engaged in the construction that the subcontractor has complied with the local building code. Conn. Gen. Stat. § 47-121. Plaintiff contends that this building code warranty reflects the Connecticut legislature's embrace of the "public policy considerations underlying *Minton*." (Pl. Br. at 27.) Plaintiff is wrong.

Connecticut's building code warranty bears no resemblance to *Minton.* For one, subcontractors' obligations under the building code warranty are not conditioned on the financial solvency of a builder- or developer-vendor. Further, the building code warranty is distinct from the warranty of habitability: the building code warranty does not arise from the *sale* of a new home and does not warrant the *habitability* of that new construction. The Connecticut

legislature provided separately for an implied warranty of habitability in an entirely distinct section of the New Homes Warranties Act. Conn. Gen. Stat. § 47–118. Notably, plaintiff does not suggest that any Connecticut court has ever extended the implied warranty of habitability to subcontractors involved in the construction, but not party to the sale, of a new home.

As one court observed, "[t]he *Minton* case represents an isolated extension rather than the general consensus." *Village of White Birch Town Homeowner's Association v. Goodman Associates, Inc.*, 824 N.W.2d 561, 2012 Iowa App. LEXIS 904 at *10 (Iowa Ct. App. 2012). This Court should adhere to the general consensus and reject the *Minton* court's expansion of the implied warranty of habitability to subcontractors.

## III. If this Court adopts *Minton's* expansion of the implied warranty of habitability, the test should be lack of recourse rather than insolvency.

### A. "Recourse" presents a superior alternative to insolvency.

In *Minton*, the First District held that the expansion of the implied warranty of habitability to subcontractors was justified "where the innocent purchaser has *no recourse* to the builder-vendor." (Emphasis added.) 116 Ill. App. 3d at 855. In *Minton*, the purchaser lacked recourse because the builder-vendor had "been dissolved as an entity and [was] insolvent." *Id.* at 854. But the expansion of liability was premised on the lack of recourse, not the dissolution or insolvency of the builder-vendor on their own. The court's purpose was to ensure that the innocent purchaser was not left without a remedy—that the purchaser has some available recourse. If the implied

warranty is to be expanded beyond the builder- or developer-vendor, "lack of recourse" is the appropriate trigger.

### 1. A lack of recourse test is easily applied.

"'No recourse' is defined as '[t]he lack of means by which to obtain reimbursement from, or a judgment against, a person or entity.'" (Pl. Br. at 34, quoting Black's Law Dictionary (10th ed. 2014)). A "no recourse" test will not as plaintiff contends, require any complex analysis of the value of a builder or developer's assets or whether those assets might be adequate to satisfy a potential judgment in full. Rather, a "no recourse" test would require a trial court to determine only whether a purchaser either: (1) is able to pursue a judgment against a builder- or developer-vendor; or (2) has some means of otherwise obtaining reimbursement from the builder- or developer-vendor.

Such a test is easily applied in this case. It is indisputable that plaintiff is able in this case to pursue a judgment against both the builder and developer. Plaintiff obtained relief from the bankruptcy stay specifically so that it could pursue a judgment against both the builder- and developer-vendor to the extent of their insurance coverage, and has claims currently pending in this very case seeking judgment against both the builder and developer.

#### a. A purported declaratory action, *dehors* the record, does not show lack of recourse.

Citing neither the record on appeal nor any public record of which this Court could take judicial notice, plaintiff argues that an insurance carrier's declaratory action denying coverage has cast doubt on plaintiff's ability to

obtain recourse. (Pl. Br. at 30.) No evidence of this purported declaratory action appears in the record on appeal and plaintiff provides no information regarding the declaratory action: plaintiff does not identify a case number for the declaratory action, does not indicate when the declaratory action was filed, and does not identify the insurance carrier seeking the declaratory judgment. Plaintiff simply states, without any further explanation or citation, that an "insurance carrier could file a declaratory action—which they have here." (Pl. Br. at 30.)

As a general rule, a reviewing court is restricted to the record on appeal when reviewing the lower court's decision. *Unity Ventures v. Pollution Control Bd.*, 132 Ill. App. 3d 421, 430 (2d Dist. 1985), citing *People ex rel. Coats v. Sain*, 24 Ill. 2d 248 (1962). A reviewing court may consider matters *dehors* the record when addressing mootness. *Id.* This limited exception is justified because the existence of a real controversy is an essential requirement to the reviewing court's jurisdiction. *La Salle Nat'l Bank v. Chicago*, 3 Ill. 2d 375, 379 (1954). Facts affecting the reviewing court's jurisdiction may be admitted through extrinsic evidence, even though not in the record. *Id.*

No claim of mootness has been raised, nor has plaintiff invoked any other exception that would allow consideration of matters *dehors* the record. This Court should not consider the purported declaratory action when considering the issues before it.

Assuming that a declaratory action has in fact been filed, moreover, the mere filing of that action does not deprive plaintiff of recourse but at most raises a possibility that plaintiff might in the future lack recourse. Should the court in the purported declaratory action confirm that coverage is available under the applicable policies, then plaintiff's ability to pursue a judgment to the extent of that coverage will likewise be confirmed. If the court in the purported declaratory action determines that coverage is unavailable, and if that lack of coverage is sufficient to establish a lack of recourse, then and only then would plaintiff have a viable claim against the subcontractors under a "no recourse" test. Plaintiff should not be permitted to pursue judgments against the builder and developer to the extent of their available insurance coverage and at the same time claim that it lacks recourse because such coverage is unavailable.

In fact, the Illinois Insurance Code expressly provides that an insurer's obligations under a liability insurance policy persist despite the insolvency of an insured. 215 ILCS 5/388. In other words, the Illinois legislature sought to insure that an insured's insolvency will not impair an injured party's right to recourse under a liability insurance policy. The insolvency test plaintiff urges this Court to approve would effectively circumvent this legislative protection, relieving an insolvent builder or developer's insurer of its obligations by shifting liability to subcontractors.

If the purpose of expanding the implied warranty of habitability to subcontractors is to protect innocent purchasers and to hold a builder- or developer responsible for defects, then expanding the implied warranty to shift responsibility to subcontractors is not justified where a purchaser still has available recourse pursuant to a builder- or developer-vendor's insurance. As such, the "no recourse" test applied by the *Minton* court – even where the builder-vendor was dissolved and insolvent – ensures that the innocent purchaser is not left without a remedy and has some available recourse.

**b. The developer's warranty escrow fund provided recourse.**

Plaintiff also has means of otherwise obtaining recourse from the builder- or developer-vendor in this case. Specifically, plaintiff has already been reimbursed from the developer's warranty escrow fund. (See C4274, C4280.) Plaintiff claims that the warranty fund did not belong to the developer or its bankruptcy estate and so is not relevant to establish solvency. But plaintiff recovered $308,285.48 from the warranty fund—the fund is relevant to the availability of recourse. (See C4159-63.)

Plaintiff asserts that "[t]he municipality could change the law regarding the use and payout of the proceeds held in the warranty fund" or could "sweep the funds into other accounts and use the funds for other purposes."(Pl. Br. at 29–30.) Legally, this contention is baseless and supported by no citation of authority. The Evanston ordinance, which required the developer to "set up

escrows or other appropriate security," is not a municipal fund owned by the City of Evanston, but an escrow of the developer's funds established to ensure satisfaction of warranties. Evanston Code of Ordinances, §5–4–3–4(D). The warranty fund reverts to the sole control of the seller upon expiration of the warranty period in the absence of outstanding claims. *Id.* The municipality has no control over the funds. Accordingly, plaintiff's concern about the municipality taking control of the funds or using them for other purposes is unfounded.

And in any event, hypothetical changes the municipality might make to its ordinance affecting some future case are irrelevant to the present one. Escrowed funds have already been distributed to plaintiff. (See C4274, C4280.) Plaintiff has already obtained recourse.

**2. A "no recourse" test only becomes difficult to apply if plaintiff's "adequate recourse" qualification is adopted.**

A "lack of recourse" standard becomes difficult to apply only if plaintiff's "lack of *adequate* recourse" adaptation of that standard is adopted. The adequacy of recourse should be considered, plaintiff argues, because otherwise "a builder/general contractor with assets equal to $1, a nominal amount, is sufficient for the Subcontractors to avoid liability." (Pl. Br. at 34.) Plaintiff fails to appreciate, it seems, that the insolvency standard it advocates would lead to the same result: a builder/developer with $1 in assets and no

outstanding debt would be solvent, as defined by the appellate court here, because its liabilities do not exceed its assets.

A standard requiring "adequate" recourse would effectively force parties to fully litigate a plaintiff's damages before the court could determine whether a subcontractor should be a defendant at all. After all, how could a court possibly assess the adequacy of a builder- or developer-vendor's assets to fully satisfy a judgment without first determining what that potential judgment might be?

Plaintiff also does not explain why an implied warranty plaintiff should have a greater right to full satisfaction of a judgment than any other plaintiff. A plaintiff gravely injured in a catastrophic motor vehicle collision, for example, does not acquire the right to sue a party not otherwise liable simply because a defendant driver's insurance limits (and personal assets) are insufficient to fully satisfy the plaintiff's damages. And, like the insolvency standard, a test of *adequate* resource will require complex analyses of a builder- or developer-vendor's balance sheets and capitalization.

### B. "Insolvency" is not superior to "lack of recourse" as a basis for expanding a subcontractor's duties.

Echoing the appellate court, plaintiff insists that an insolvency test is "infinitely more clear and uses an analysis familiar to courts." (Pl. Br. at 31.) "Insolvency" is indeed a concept familiar in a variety of legal contexts—and cases addressing insolvency in those other contexts demonstrate that a

determination of "insolvency" is not nearly so simple an analysis as plaintiff and the appellate court assume. No single rule for determining solvency prevails; rather, "insolvency is a term which has been variously defined." *Europlast, Ltd. v. Oak Switch Sys.*, 10 F.3d 1266, 1271 (7th Cir. 1993), quoting *Brusselback, et al. v. Chicago Joint Stock Land Bank*, 85 F.2d 617 (7th Cir. 1936).

Varying definitions of insolvency appear in a wide range of statutes, including (but not limited to) Illinois' Limited Liability Company Act (805 ILCS 180/1-5), the Uniform Fraudulent Transfers Act (740 ILCS 160/3), the Uniform Commercial Code (810 ILCS 5/1–201(b)(23)) and the Bankruptcy Code (11 U.S.C. § 101(32)). Courts have recognized a variety of tests for evaluating solvency, including the "balance sheet," "liquidity," "capitalization of earnings," and "cash flow tests." See, e.g., *Marshall v. Marshall (In re Marshall)*, 721 F.3d 1032, 1061 (9th Cir. 2013), *In re Loyal Cheese Co.*, 969 F.2d 515, 519 (7th Cir. 1992), and *Paloian v. LaSalle Bank Nat'l Ass'n (In re Doctors Hospital of Hyde Park)*, 507 B.R. 558, 638 (Bankr. N.D. Ill. 2013). Conditioning a subcontractor's liability on the insolvency of a builder- or developer-vendor will require this Court to determine which of these competing tests for insolvency should apply.

An insolvency determination also requires a fair valuation of assets and liabilities, including a determination of the expected value of any contingent assets and liabilities. *In re Xonics Photochemical*, 841 F.2d 198, 200 (7th Cir.

1988). As plaintiff correctly notes, the "value of any asset is inherently variable." (Pl. Br. at 29.) Conditioning subcontractor liability on a builder or developer's insolvency will require an inquiry into, and expert valuation of, the builder or developer's assets and liabilities—an inquiry which could prove vexing if the builder or developer is not a party obligated to respond to discovery.

And conditioning subcontractor liability on the solvency of a builder or developer will undoubtedly invite attempts to pierce the corporate veil of the purportedly insolvent entities. If a subcontractor were to pierce the corporate veil by demonstrating that a builder or developer LLC was "a mere façade for the operation of the dominant" member (see, e.g., *Bank of Am. v. WS Mgmt., Inc.*, 2015 IL App (1st) 132551, ¶100), then establishing the insolvency of the LLC would presumably not establish the insolvency of the actual builder or developer.

Plaintiff also argues that a "no recourse" test is inappropriate because "[t]here is no protection from the builder/general contractor moving or selling an asset during the pleading stage," divesting themselves of assets in order to become "judgment proof." (Pl. Br. at 29.) But, in fact, there is protection from such shenanigans: the Uniform Fraudulent Transfers Act specifically provides remedies where asset transfers are made for the purpose of avoiding claims. 740 ILCS 160/8. Plaintiff fails to explain why it would be equitable to force an

innocent subcontractor to bear the burden of protecting homeowners from the possibility of a builder or developer's fraudulent transfers.

Shifting liability to subcontractors based on the insolvency of a builder- or developer-vendor ultimately undermines the policy objective of holding builder-vendors accountable for latent defects. By structuring as a single-purpose limited liability company that will be insolvent by design once all condominium units have been sold (as the developer TR Sienna did here), a developer can effectively evade all liability for latent defects under the insolvency approach advocated by plaintiff.

In sum, if the Court does not overrule *Minton's* expansion of the implied warranty of habitability in its entirety, then the Court should also adopt *Minton's* "no recourse" approach over the "insolvency" test applied by the appellate court below. The Court needs look no further than the circumstances here to see that the "no recourse" standard is the superior alternative to insolvency.

Given plaintiff's recovery of the warranty fund already and ongoing pursuit of its claims against the developer and general contractor, application of the "no recourse" requirement affords adequate protection to the innocent purchasers. Therefore, the appellate court's application of the supposedly "easier" insolvency test in this case demonstrates that it is overbroad since it expands the potential liability of subcontractors unnecessarily where the innocent purchasers are already protected by the available recourse. Further,

the "insolvency" test may also be too narrow when applied in other circumstances and leave innocent purchasers without any remedy where the purchaser's potential damages far exceed the developer or builder's limited assets notwithstanding their balance-sheet solvency.

## CONCLUSION

For the foregoing reasons, Petitioners respectfully request that this Court overrule *Minton* in its entirety, or in the alternative, require a showing that the purchaser has no "recourse" to the builder or developer before the implied warranty of habitability can be extended to subcontractors or material suppliers.

Respectfully submitted,

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Dated: July 3, 2018

## CERTIFICATION OF COMPLIANCE

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of the brief, excluding the pages containing the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, the Rule 341(c) certificate of compliance, and the certificate of service, and those matters to be appended to the brief under Rule 342(a) is 5,994 words.

/s/ Kimberly A. Jansen

## CERTIFICATE OF SERVICE

On July 3, 2018, I filed the foregoing Appellants' Reply Brief by electronic means on the Clerk of the Illinois Supreme Court.

On July 3, 2018, I also served the Appellants' Reply Brief on counsel of record for all parties in this case by sending a copy to each of the email addresses contained in the attached service list.

Under penalties as provided by law pursuant to Section 1-109 of the Code of Civil Procedure (735 ILCS 5/1-109), the undersigned certifies that the statements set forth in this instrument are true and correct.

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