WE NEED A NEW STADIUM – IF YOU BUILD IT, SUITS WILL COME: CONSTRUCTION COVERAGE ISSUES

Presented and Prepared by:
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The cases and materials presented here are in summary and outline form. To be certain of their applicability and use for specific claims, we recommend the entire opinions and statutes be read and counsel consulted.

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The majority of case law involving construction coverage issues includes faulty workmanship, construction defects, professional design liability, and indemnification provisions (hold harmless, defense, indemnity, additional insured coverage).

The following is a list or "survey" of recent and significant decisions involving Construction Coverage Issues. We provide you with a brief summary of the result only. Each of these decisions includes an excellent discussion and evaluation of Illinois case law that lead to these decisions. We encourage the reader not to rely only on these brief summaries, but rather, to pull the complete decision if you require a more detailed analysis to assist you in the evaluation of any claims you may have.

I. NO CGL COVERAGE FOR CONTRACTOR'S ALLEGED FAULTY WORKMANSHIP

A. Policy Required An Accident To Trigger Coverage; Workmanship Not Covered

In *Westfield Insurance Co. v. West Van Buren, LLC,* 2016 IL App (1st) 140862, the Illinois Appellate Court, First District, decided whether the insurer had a duty to defend and indemnify a developer where the policy issued to the roofing subcontractor required an accidental event to trigger coverage. The court affirmed the lower court's decision granting summary judgment in favor of the insurer because the complaint only alleged shoddy workmanship by the roofing contractor.

In *Westfield*, the roof leaked a year after construction, causing damage to many of the condo units. The condo association sought reimbursement from the developer, who in turn requested that Westfield provide a defense and indemnity for the claim. The underlying complaint against the developer alleged that the defendant breached contractual warranties and also committed fraud in selling the condo units because it intentionally concealed hidden defects in the roofing system "so as to allow water infiltration into the Condo Building." *Westfield*, 2016 IL App (1st) 140862, ¶ 6.

The appellate court concluded that Westfield had no duty to defend the developer in the underlying action because (1) the policy essentially requires an accidental event to trigger coverage, yet there was nothing accidental alleged in the complaint, which either focused on the developer's intentional bad acts or non-fortuitous events; and (2) the allegations did not fall within the definition of property damage under the policy's plain language because they sought only to hold the developer responsible for the shoddy workmanship of its roofing subcontractor.

B. Allegations of Damage to Structure Insufficient to Trigger Duty to Defend Under Occurrence-Based Policy

In *Lagestee-Mulder, Inc. v. Consolidated Insurance Co.,* 682 F.3d 1054 (7th Cir. 2012), the Seventh Circuit Federal Court, applying Illinois law, affirmed the lower court's decision finding no coverage under a subcontractor's occurrence-based policy for a claim against the GC for water infiltration and other construction defects that occurred during the construction of the building. The court found that the allegations of workmanship and deficiencies in materials were insufficient to trigger coverage as they did not allege damage to anything other than the building itself.

II. PRIMARY VERSUS EXCESS COVERAGE – WHO'S FIRST?

A. Construction CGL Policy Provides Only Excess Coverage Where Other Primary Coverage Was Available

In *Certain Underwriters at Lloyd's, London v. Central Mutual Insurance Co.,* 2014 IL App (1st) 133145, the Appellate Court, First District, held that the clear and unambiguous condition precedent language in the commercial general liability insurance policy was not satisfied and the policy provided only excess coverage to the insured for the negligence lawsuit.

The general contractor (GC) was the named insured on a CGL policy it obtained from Lloyd's and an additional insured on a CGL policy the electrical subcontractor (Sub) obtained from Central. When the Sub's employee was hurt on the job, the two insurers disagreed as to which was the primary insurer and which was the excess insurer. While the Sub was contractually obligated to maintain insurance for the GC, the contract did not say if the policy had to be primary or excess.

The appellate court affirmed the lower court's ruling that the additional insurance provided by Central (the Sub's policy) defaulted to being excess because (1) the agreement between the GC and the Sub was silent as to whether the additional coverage obtained for the GC was to be primary or excess, and (2) the "other insurance" clause in the subcontractor's insurance policy stated that coverage would be excess unless the GC-Sub contract required that the insurance be primary.

III. WHO IS AN INSURED?

A. No Duty to Defend - GC Is Only a Certificate Holder, Not an Insured

In *Owners Insurance Co. v. Seamless Gutter Corp.,* 2011 IL App (1st) 082924-B, the Appellate Court, First District, decided whether the subcontractor's CGL policy applied to the GC (a direct defendant in the underlying bodily injury lawsuit) and to the subcontractor (the purchaser of the policy, and third party defendant). The appellate court held that since the GC was not an additional insured under the subcontractor's policy, there was no duty to defend the GC. The GC

was an additional insured under earlier policies, but not the policy in effect at the time of the incident. The court noted that the GC should have been alerted when this happened, but there was no evidence of this or that it ever even requested a copy of the policy.

The appellate court also held that the GC was not an additional insured under the written contract provision of the policy. Because the construction contract did not require that the subcontractor provide umbrella coverage, the insurer was not required to provide coverage under the written contract provision of the Auto Owner's policy.

Also, the appellate court found that there was coverage for the subcontractor, and thus no duty to defend the Sub, under the employee exclusion clause in the Auto Owner's policy. In order for the employee exclusion to apply, the injured person had to have been both an employee of the purchaser (Sub) and in the course of his employment with the purchaser at the time of the accident. While the third party complaint alleged that the injured claimant was an employee of the Sub, there was no allegation that he was working in the course of his employment at the time.

IV. DUTY TO DEFEND – ALLEGING TOO MUCH?

A. Duty to Defend Found Where Potential Basis for Vicarious Liability Exists

In *Pekin Insurance Co. v. Centex Homes,* 2017 IL App (1st) 153601, the Appellate Court, First District, found that the GC was an additional insured where the potential existed that a jury could find that the insured subcontractor was negligent in the erection of a wall, and that the GC retained sufficient control over that element of the construction project such that the Sub was its agent.

The CGL policy contained an additional insured endorsement that covered "any person or … for whom you are performing operations, when you and such person…have agreed in a written contract … that you must add that person … as an additional insured on a policy of liability insurance" and that additional insureds were covered "only with respect to vicarious liability for 'bodily injury,' or 'property damage'…." *Centex*, 2017 IL App (1st) 153601, ¶ 6.

Thus, the appellate court also held that the managing partner of the GC was not an additional insured because it had merely signed the construction contract as a representative or agent of the GC. The GC was the signatory and the only party to the written contract with the insured subcontractor.

B. Duty to Defend Even if Allegations of Direct and Vicarious Liability

In *Pekin Insurance Co. v. CSR Roofing Contractors, Inc.,* 2015 IL App (1st) 142473, the Appellate Court, First District, ruled that a GC is entitled to coverage under a CGL policy even if the complaint alleges both direct and vicarious liability. The mere fact that allegations of direct

liability are included in the complaint does not defeat the GC's claim that it could also potentially be held vicariously liable. For instance, the underlying complaint alleges that as an employee of the subcontractor, the injured person did not have appropriate safety devices while working on the roof, in violation of OSHA regulations. The complaint alleges that the GC "allowed its subcontractors to not be competent in violation of OSHA regulations" and "failed to require the subcontractor … to comply with OSHA regulations." *CSR Roofing*, 2015 IL App (1st) 142473, ¶ 12.

V. COVERAGE IN CONSTRUCTION DEFECT CASES

A. Illinois Courts Have Routinely not Found Insurance Coverage Under CGL Policies for Construction Defect Claims Unless the Claim Is for Damage to Property Other Than the Insured's Work.

In *CMK Development Corp. v. West Bend Mutual Insurance Co.,* 395 Ill. App. 3d 830 (1st Dist. 2009), the Appellate Court, First District, held that various construction defects alleged against the insured builder were outside the scope of the policy's coverage, such as defective concrete, water damage to a lower level cork floor, and scratches on a bathtub and toilet. The builder argued that defects were damage to "other property" and thus covered. The court disagreed and found that the homeowners did not get what they had bargained for (a new home free of defects), which was a breach of the construction contract.

Similarly, in *Stoneridge Development Co., Inc. v. Essex Insurance Co.,* 382 Ill. App. 3d 731 (2d Dist. 2008), the second district court held that there was no coverage for construction defects, including cracks in the foundation, resulting from the insured contractor's faulty soil compaction. The court concluded that damage to the homeowners' home did not constitute an "occurrence" or "property damage" under the insurer's policy. Cracks that developed in the home were not an unforeseen occurrence that would qualify as an "accident," because they were "natural and ordinary consequences" of defective workmanship, namely, the faulty soil compaction. While defective workmanship could be covered if it damaged something other than the project itself, the alleged damage was only to the home. Thus, there was no "occurrence."

However, see *Country Mutual Insurance Co. v. Carr,* 372 Ill. App. 3d 335 (4th Dist. 2007), in which the Appellate Court, Fourth District, wrote a confusing decision providing that the plaintiff in the underlying complaint had sufficiently alleged a claim for damage to their basement walls when a subcontractor used the wrong backfill around the plaintiff's walls, which caused the walls to sustain "sudden movement and damage." However, that decision has since been criticized by several cases including *Nautilus Insurance Co. v. 1735 W. Diversey, LLC,* No. 10C 425, U.S. Dist. 2011 LEXIS 82246 (N.D. Ill. July 21, 2011).

VI. PROFESSIONAL LIABILITY & DESIGN DEFECT CLAIMS

A. Professional Services Exclusion Argument Rejected Because of "Separation of Insureds" Condition

In *Patrick Engineering, Inc. v. Old Republic General Insurance Co.,* 2012 IL App (2d) 111111, the Appellate Court, Second District, held that whether there was coverage for a utility company under the engineering firm's policy will be determined by "separation of insureds" provision, which required that coverage for the utility company be evaluated separate and apart from the engineering firm. The engineering firm had been retained to provide design services to a utility company to relocate utility poles. The utility company was an additional insured under the engineering firm's policy. While the utility company was relocating the poles, it struck and damaged the city sewers. The engineering firm's insurer denied coverage to the utility company based on its "professional services" exclusion, claiming that the insured engineer's design work was "professional" in nature. The second district court rejected this, finding that the "professional services" exclusion applied to exclude only professional services performed by the engineering firm, not the utility company, which was being sued for its own, non-professional negligence in damaging the city sewer.

Mark J. McClenathan

- Partner

Mark concentrates his practice in commercial and civil litigation. He has extensively defended product liability, professional and construction liability, trucking, and agriculture liability cases. He is chair of the firm's Construction Practice.

Mark has handled cases in state courts in more than 19 counties in northern Illinois, including Cook County, and in federal court in the Northern District of Illinois. He has successfully tried numerous high-exposure construction, trucking, and product liability cases to verdict. In October 2012, Mark obtained a defense verdict for a trucking company in a wrongful death lawsuit in LaSalle County, IL where the plaintiff claimed violations of numerous federal and state trucking regulations.

Mark has an extensive background in building construction and mechanics. Mark has also successfully defended product liability cases involving construction equipment, automobiles and trucks, industrial equipment and machine tools, and hunting products. Mark has represented manufacturers and retailers of ladders, cranes, machine tools, engines, fuel systems (in semi-tractor trucks and luxury yachts), deer hunting stands, electrical systems and equipment, food manufacturing equipment, amusement park attractions, building materials, and lawnmowers. He has represented numerous general and subcontractors in building, civil and road projects. As part of his professional liability practice, Mark has defended engineers, architects, agents and brokers, and real estate appraisers.

Mark has successfully defended farmers, farm service companies and co-ops, and grain storage facilities. Mark has recently defended cases involving chemical spills and spray drift/off target claims, crop and nursery damage claims, farm equipment accidents, and grain bin fatalities.

In addition, Mark has represented clients in the areas of business and corporate law, construction law, and real estate. Also, Mark has represented municipalities and clients before various governmental bodies, and has experience in annexations, subdivisions and developments, zoning, and intergovernmental agreements.

Mark joined Heyl Royster in 1989, and became a partner with the firm in 1998. Prior to joining Heyl Royster, Mark worked for the legal department of the Defense Logistics Agency (Defense Contract Services) of the Department of Defense in Chicago; the legal departments of Land O'Lakes, Inc. in St. Paul and 3M Corporation in Minneapolis.

Significant Cases

- Represented a restaurant and bar at trial in a wrongful death lawsuit in Winnebago County, IL involving the shooting of the plaintiff decedent. Obtained summary judgment on the Dram Shop counts before trial, and obtained a defense verdict on the remaining negligence counts at trial.
- Represented a trucking company at trial in a wrongful death lawsuit in LaSalle County, IL where the plaintiff claimed violations of numerous federal and state trucking regulations. At trial, Mark obtained a defense verdict.
- Defended and obtained dismissal of a federal lawsuit filed against the designer and builder of an ethanol plant in which the owner claimed lost income and production resulting from several fires at the plant.
- Represented civil engineers and highway construction contractors in defense of complex claims relating to road construction design, construction supervision, and alleged road defects (such as failed concrete, pavement markings, construction signage), leading to personal injuries and wrongful death claims. Mark obtained dismissal of all claims.
- Defended a complex claim, including claims for injunctive relief and breach of contract, brought by an Illinois municipality against its cable franchisee for alleged violations of a Franchise Agreement, including litigation over the interpretation of the amended Illinois Cable and Video Customer Protection Law, 220 ILCS 5/22-501(b)(3) and related municipal regulations.

- Defended and obtained dismissal of a federal claim against a farm service for negligently spraying a farmer's corn crop with a herbicide in violation of federal statutes, rules and regulations, and allegedly destroying his corn crop.
- Defended and obtained dismissal of two separate preferential treatment claims in the U.S. Bankruptcy Court against creditors of companies filing for bankruptcy, and successfully prosecuted a Section 523 Complaint to Determine the Dischargeability of a Debt in a construction case.

Transactions

- Assisted various municipalities on incorporations; drafting new or amending existing zoning, subdivision, and general ordinances; drafting comprehensive plans; negotiating and drafting border agreements and annexation agreements.
- Represented municipalities in court on border disputes.
- Represented municipalities before administrative boards on disciplinary proceedings (including police issues).
- Represented Ken Rock Community Center on sale of commercial/school property.

Publications

- "Crossing the Line: Interference with Business and Contractual Relations," *Illinois Defense Counsel Quarterly Monograph* (2017)
- "Proposed Law Would Not Allow Counties to Set Standards for Wind-Farms," *Heyl Royster Governmental Practice Client Alert* (2014)
- "Sale of Goods - Disclaiming of Warranties and Consequential Damages," *Heyl Royster Business & Commercial Litigation Newsletter* (2014)
- "Municipal Bankruptcy - Can an Illinois Municipality File for Bankruptcy Protection?" *Heyl Royster Governmental Newsletter* (2014)

Public Speaking

- *"Get Organized"*
  Heyl Royster Governmental Seminar (2016)
- *"Liability Protection: How to Prevent the Piercing of the Corporate Veil"*
  Northern Illinois Builders Contractors Association (NIBCA) (2016)
- *"Preserving Electronic Information: Protect your business in the event of a lawsuit or the threat of a lawsuit."*
  Heyl Royster "Avoiding Litigation" Seminar, Urbana, IL (2016)
- *"Staying Out of Litigation: When to Require Liability Waivers"*
  IAPD/IPRA "Soaring to New Heights" Conference (2016)
- *"Alternative Dispute Resolution – 'Using mediation or arbitration early to avoid lawsuits later.'"*
  Heyl Royster "Avoiding Litigation" Seminar, Rockford and Peoria (2016)
- *"Vicarious Liability – 'Why Should I Care?'"*
  Heyl Royster 'Avoiding Litigation" Seminar, Rockford and Peoria (2016)
- *"Concealed Carry: Illinois Law in Review"*
  Heyl Royster's 30th Annual Claims Handling Seminar (2015)
- *"Discrimination and Retaliation (Civil Rights Act, ADEA, ADA, and other)"*
  Recent Legal Decisions Affecting Businesses & Employers, Heyl Royster Seminar (2015)

Professional Recognition

- Selected as a *Leading Lawyer* in Illinois. Only five percent of lawyers in the state are named as *Leading Lawyers*
- Winnebago County Pro Bono Volunteer of the Year (1990)
- Court certified mediator, Winnebago County

Professional Associations

- Winnebago County Bar Association
- Illinois State Bar Association
- Illinois Association of Defense Trial Counsel (Chair, Commercial Law Committee 2016-2016; former Chair, Construction Law Committee 2015-2016)
- Defense Research Institute

Court Admissions

- State Courts of Illinois
- United States District Court, Northern District of Illinois

Education

- Juris Doctor, Hamline University School of Law, 1987
- Bachelor of Arts (*magna cum laude*), University of Wisconsin - Eau Claire, 1984
- Porter Scholar, Beloit College, 1979-1980