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Building Knowledge

The newsletter of the Illinois State Bar Association's Section on Construction Law

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Editor's Note

BY SAMUEL H. LEVINE

This edition of the Building Knowledge newsletter contains two compelling articles. The Hon. Lisa Curcio (ret.) walks us through mediating complex construction claims. Judge Curcio (ret.) is a former judge in the Cook County Circuit Court Chancery Division, Mortgage Foreclosure/Mechanics Lien Section. She mediates and arbitrates construction disputes for ADR Systems.

Clifford Shapiro analyzes Illinois and sister state law regarding whether property damage caused by defective construction work of a general contractor or a subcontractor constitutes an accidental "occurrence" under the standard form Commercial General Liability ("CGL") insurance policy. Clif is chair of the Barnes & Thornburg Construction Law Practice Group. Clif is an arbitrator, mediator, and construction attorney, whose practice includes assisting clients with insurance coverage issues in the construction claim context.

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Can We Mediate Complex Construction Claims?

BY HON. LISA CURCIO (RET.)

Non-payment, claims of defective work, delays, claims for extra work with unsigned change orders, design issues, outstanding requests for information, acceleration... A major construction project is in trouble and owners, architects, design professionals, engineers, prime contractors, subcontractors and suppliers are all pointing fingers, making claims on payment and performance bonds, and filing lawsuits. Parties want to complete the project and to be paid, but litigation frustrates those goals because it drains energy and money. The solution can be mediation.

While a judge or jury decides the outcome of litigation, the parties control the outcome of mediation. Mediation is flexible. It allows the parties to decide how to achieve their ultimate goals. Parties who want to maintain relationships have a better chance of doing so through mediation. Mediation is private and confidential, while litigation is public. The cost of mediation pales in comparison to the time, money and emotion expended in litigation.

Successful mediation requires careful planning. The first crucial step is to define "success" in the context of the claims. Is it global monetary settlement or monetary settlement of only some claims such as claims of subcontractors and material suppliers? Will mediation narrow or resolve particular issues? With everyone at the table, can the parties fashion an agreement that will complete the project? The possibilities are only limited by the creativity of the parties.

Choose the right time to mediate. If all or some of the parties are still talking and working, early mediation can be effective. When communication has failed and positions have hardened, some exchange

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Mark your calendars for March 13, 2020 for the ISBA Construction Law Section Construction Law Primer for New Attorneys and General Practioners. Attendees at the full day program will learn about the construction process, construction contracts, the payment process, construction claims and much more. Check the ISBA CLE page for additional details.■

Can We Mediate Complex Construction Claims?

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of documents and even expert assessments might be required to successfully move forward.

Choose the right mediator. Mediating a complex construction case requires knowledge of the industry and the typical (insofar as "typical" exists) progression of a major project. The mediator should understand not just contract law, but construction law. The mediator's personality and "style" can contribute to success or failure. Sometimes cases settle days or weeks later. Will the mediator stay engaged? Consult with others in your firm and with colleagues and opponents for recommendations. If you are scheduling the mediation through an alternative dispute resolution company, discuss the case with case coordinators and managers to get their suggestions.

Schedule enough time. Complex cases, whether because there are many parties, many issues, or both, require more time. Consider scheduling subcontractor claims on one day and general contractor/owner claims on another. Parties who are aligned on issues can streamline the process by working together to present their claims. Avoid having party representatives feel their time is wasted coming to mediation and sitting for long hours without being heard.

Prepare! Work done before the mediation will make mediation more productive. Attorneys must put on the "counsellor hat" to educate clients about the processes, the costs, and the risks of litigation and of mediation to allow the parties to make informed business decisions. Even the most experienced and sophisticated clients need an objective evaluation of the case. Honest discussion of potential problems with the claim is essential to achieving the clients' goals.

Conduct pre-mediation conferences with the mediator either in person or by telephone. There should be at least one call or meeting involving all counsel for an overview of the status of the litigation and of the claims and the issues. It assists the mediator to understand the present relationships of the parties, the settlement status, and the issues parties see as particular barriers to settlement. Then, since there is no such thing as an *ex parte* communication in mediation, the mediator and parties can plan separate conferences to discuss issues particular to one party or that the attorneys want to keep confidential.

Written submissions might be the most important pre-mediation work. They should outline the parties' claims and theories. Concisely articulate the legal and factual support for the claims to educate the mediator. Itemize potential damages. Make a clear demand. Include documents that illustrate and support claims and damages. The submissions should be shared with all parties so everyone can realistically evaluate the claims and risks and engage in effective negotiation. If there is information that is truly confidential but might be useful to the mediator during the mediation, it can be submitted separately for the mediator's eyes only.

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No matter what the objective, client representatives with authority to decide and to bind must attend the mediation. Mediation without the physical presence of those representatives is almost always an effort in futility. Others with particular knowledge of the issues can also contribute to resolution. These might be non-party witnesses or experts.

Will opening comments help or hurt? Opening comments should educate, not alienate. Presentations by experts to neutrally explain differences on complex issues can assist the parties and the mediator to understand the nuances of the case. Adversarial statements by attorneys lead to anger that then must be defused before meaningful discussions can begin.

Creative thinking is important in all mediation, but especially so in multi-party, multi-issue construction cases. Some claims will require monetary settlement. Others might require reworking relationships or contracts so a project can move forward. An open mind is the best tool in the belt when it comes to mediation.

Last, but absolutely not least, when you reach agreement do not leave until there is a signed Memorandum of Understanding of the material terms. Bring your laptop with a pre-drafted agreement shell and fill in the blanks when the agreement is made. The extra few minutes spent getting a signed agreement assures that everyone knows and acknowledges the settlement terms. In the worst case scenario that someone goes back to the office and has second thoughts, your signed agreement is the best evidence for the court to enforce the settlement.

Complex construction claims can be resolved or narrowed through mediation. Once defined, success is achieved through preparation, honest analysis of the issues, and commitment to the process. The parties decide the outcome. Time, and money are saved. Get your clients out of the courtroom and back to work—mediate!■

Inadvertent Construction Defects Are an 'Occurrence' Under the CGL Insurance Policy! Will Illinois Ever Clean up Its Mess?

BY CLIFFORD J. SHAPIRO

Whether property damage caused by defective construction work constitutes an accidental "occurrence" under the standard form Commercial General Liability ("CGL") insurance policy is now highly dependent on which state's law applies. Determining which state's law applies to a particular construction defect claim is therefore critical and often outcome determinative. This article provides a 50 state survey of the occurrence issue and discusses some of the correct and the incorrect ways that courts are currently addressing this issue. The article focuses on the failed state of the law in Illinois, a state that continues to use an incorrect and outdated analysis to determine whether construction defects constitute an "occurrence" under the CGL insurance policy.

The current status of each's state's law can be found in the Barnes & Thornburg Construction Law Practice Group's 50 state survey of the "occurrence" issue, which can be found here: https://www.btlaw.com/insights/publications/insurance-coverage-for-construction-defects-2018-50-state-survey.

A majority of jurisdictions find that defective or faulty workmanship can constitute an "occurrence" under the modern day CGL insurance policy. Generally, these jurisdictions find that defective construction work that occurs unintentionally is a fortuitous "accident," and therefore an "occurrence" within the meaning of the coverage grant in the CGL policy, or they find that unintentional defective work can constitute an accidental "occurrence" if the defective work causes property damage to something other than the defective work itself. In all of these jurisdictions, a policyholder can potentially trigger coverage for a construction defect claim, assuming other terms and exclusions in the policy do not apply to bar coverage.

A minority of jurisdictions still hold that construction defect claims do not, and cannot, give rise to an accidental "occurrence" within the meaning of the CGL insurance policy, and therefore refuse to provide any coverage at all for construction defect claims. This is the situation in Illinois, and frankly the law in Illinois needs to be corrected.

Understanding 'Occurrence' Under the CGL Policy

The modern day CGL insurance policy contains two key parts, namely, the coverage grant and the policy exclusions. The coverage grant broadly provides insurance coverage up to the policy limits for amounts the policyholder becomes legally obligated to pay because of "property damage" caused by an accidental "occurrence." The CGL policy then narrows and defines the actual scope

of insurance coverage for a particular claim through the many policy exclusions.

The correct legal analysis recognizes that there is an accidental "occurrence" under the CGL policy coverage grant when a claim alleges that a general contractor and/or a subcontractor caused property damage by accidentally (not intentionally) performing faulty construction work. Whether or not coverage exists for the claim is then determined by examining the various construction-specific policy exclusions that may apply to the particular situation.

The correct legal analysis examines the kind of property damage at issue only as required by the analysis of the policy exclusions, and not to determine in the first instance if the claim involves an accidental "occurrence." This is a very important difference. A threshold finding of no "occurrence" is an absolute bar to coverage, which means there is no possibility of coverage and therefore no duty to defend the policyholder against the claim. On the other hand, a finding that the claim involves an accidental "occurrence" then requires analysis of the claim under the policy exclusions. This often leads to a finding that there is at least potential coverage for part of the claim, the insurance company is therefore required to provide its policyholder with a defense at the carrier's cost. As a result, the applicable law regarding the "occurrence" issue can, and often does, dramatically affect the policyholder's financial posture for a construction defect claim.

The Important 'Your Work' Exclusion

A policyholder is more likely to have coverage in jurisdictions that recognize construction defects can be an "occurrence" and properly examine the applicable policy exclusions. For example, in the completed operations context, the "your work" exclusion generally applies to bar coverage for the cost to repair or replace property damage caused by the work of the policyholder, but it also has a specific "subcontractor exception" that does *not* bar coverage for property damage arising out of the work of the policyholder's subcontractors. Thus, in a jurisdiction that recognizes that construction defects can be an accidental "occurrence," a general contractor generally will have coverage for property damage caused by the work of its subcontractors.

While a *subcontractor* does not have the benefit of the subcontractor exception in the "your work" exclusion, a subcontractor can still have coverage under the correct analysis of the CGL policy if its work causes property damage to other work (i.e., property damage outside of the sub's own scope of work). The reason for this is *not* that the claim alleges an accidental "occurrence" because there is damage to other work. Rather, the correct conclusion is based on the "your work" exclusion, which generally excludes coverage for the cost to repair or replace the policyholder's own defective work, but does *not* exclude the cost to repair or replace damage to other work.

Illinois Courts Get It Wrong

The legal framework used by the Illinois courts is fundamentally flawed. In fact, it fails to apply the terms of the CGL insurance policy as intended by the insurance companies themselves.

Illinois decisions currently hold (incorrectly) that inadvertent construction defects cannot be an "occurrence" unless the defective work causes property damage to something other than the "project," "building" or "structure." Most, but not all, of these decisions address the coverage question in situations where the policy holder was a general contractor. The cases find that there can never be an "occurrence" -- and that there is therefore no insurance coverage at all for the claim -- if the alleged property damage was to any property within the general contractor's scope of work. Because the general contractor's scope of work usually includes construction of the entire building or project, this analysis finds that a CGL insurance policy provides no coverage at all to a general contractor for any claim that involves property damage to the building or project. This virtually eliminates insurance coverage for construction defect claims for general contractors. Under this analysis, there can only be insurance coverage if the claim includes property damage to something other than the project or building being constructed.

Among other things, this analysis fails to apply the "your work" exclusion as intended by the insurance contract. The correct legal analysis recognizes that there would be no reason to have an exclusion for property damage caused by the "work" of the policyholder if the "occurrence" requirement in the coverage grant did not allow any possible coverage for property damage caused by inadvertent construction defects in the first place. And there would certainly be no reason for the same exclusion to have an exception that specifically restores coverage for property damage caused by the policyholder's subcontractors if there never could have been an accidental "occurrence" within the meaning of the policy's coverage grant in the first place. In short, the Illinois analysis makes the "your work" exclusion essentially meaningless.

Unfortunately, the incorrect analysis is now very established in Illinois. For more than twenty years, Illinois appellate courts have repeatedly applied the incorrect analysis to deny insurance coverage for construction industry policyholders facing construction defect claims, and the Illinois Supreme Court has never decided the issue. Illinois appellate court cases continue to hold that there can never be an "occurrence" if the policyholder is a general contractor and the alleged damage was to *any* part of the project or building itself. As a result, Illinois decisions continue incorrectly to collapse what should be a second and separate analysis of coverage under the applicable policy exclusions (including the "your work" exclusion) into the initial threshold coverage determination of whether the claim involves an accidental "occurrence."

Illinois decisions also continue to disregard or fail to apply the well accepted requirement that an insurance policy must be read and interpreted as a whole. Instead of applying the "your work" exclusion as intended, Illinois decisions often simply state that the legal analysis does need to even consider the "your work" exclusion. The decisions find that construction defect claims for property damage within the policyholder's scope of work are simply not sufficiently "fortuitous" or "accidental" to constitute an "occurrence." This reasoning is

based on an outdated judicial gloss that is not found in the insurance policy itself. It is based on old reasoning used by certain courts and commentators before the CGL policy terms were materially changed, including in 1986. Those changes to the policy modified the exclusions (including the "your work" exclusion) to clarify that the CGL policy provides coverage for certain kinds of property damage caused by inadvertent faulty workmanship, and that the scope of that coverage is found in the policy exclusions.

Illinois Coverage for Subcontractors: Correct Result/ Wrong Analysis

Until recently, there was uncertainty whether the same incorrect "scope of work" analysis for the "occurrence" issue would be applied in Illinois to claims against subcontractors. Some federal decisions held that there could be an "occurrence" if the subcontractor's defective work caused property damage to some other part of the project or building outside of its scope of work. But other decisions held that the subcontractor, like the general contractor, could not show the existence of any accidental "occurrence" if the claim involved property damage to any part of the entire project or building.

On March 29, 2019 the First District of the Illinois Appellate Court issued an opinion that directly answers the "occurrence" question for insured subcontractors. The decision finds that a subcontractor can have insurance coverage for an inadvertent construction defect claim under a CGL policy in Illinois if the claim involves property damage to a part of the project that is outside of the subcontractor's scope of work. *Acuity Insurance Co. v. 950 W. Huron Condominium Association*, 2019 IL App (1st) 180743, 2019 Ill. App. LEXIS 208. A Seventh Circuit decision now also finds that a general contractor can have coverage under its subcontractor's insurance policy as an additional insured where the general contractor is being sued for defective work performed by its subcontractor that caused damage to property outside of the subcontractor's scope of work. *Westfield Ins. Co. v. National Decorating Service*, 2017 WL 2979654 (7th Cir. 2017).

Applying Illinois' flawed analysis, *Acuity* and *Westfield* essentially arrive at the correct outcome for claims that involve resulting property damage caused by subcontractors – but for an absolutely wrong reason. Worse, the decisions do nothing to remedy current Illinois law that continues to deny coverage for general contractors even when the claim involves property damage that arises out of the work of subcontractors. Under that law, the general contractor who worked on the same project at issue in *Acuity* would not be able to obtain any insurance coverage for the loss under its own CGL policy even if the claim involved the exact same property damage caused by the same subcontractor. This is absurd, as the subcontractor exception in the "your work" exclusion should apply in this circumstance to *allow* coverage for the general contractor under these circumstances.

Similarly, while the insured subcontractor in the *Acuity* case should have insurance coverage for part of the cost to repair the property damage, it is not because the existence of property damage outside of the subcontractor's scope of work somehow created an "occurrence." Instead, the "occurrence" requirement in the policy was satisfied by the accidental and inadvertent nature of subcontractor's defective work, and the scope of coverage for the claim should have been determined by the applicable policy exclusions. Here, the subcontractor's defective work itself should be excluded from coverage under the "your work" exclusion in the subcontractor's CGL policy. But that exclusion does *not* apply to the resulting property damage to the other non-defective parts of the work, including the damage that the subcontractor caused to other parts of the project. It is for this reason, and *not* because the claim somehow fails to allege an accidental "occurrence," that the subcontractor has coverage for the resulting damage it caused to other parts of the project.

Will Illinois Law Ever Be Corrected?

The *Acuity* case presented a rare opportunity for the Illinois Supreme Court to reconsider and correct Illinois law, but unfortunately the Court recently refused to accept the opportunity to decide the case on appeal. Illinois therefore continues to have an incorrect analysis in its case law for determining whether construction defect claims are covered by the CGL insurance policy. The Illinois Supreme Court needs to consider this issue and publish a decision that finally addresses and corrects the law in Illinois, or the Illinois legislature needs to take up and pass corrective legislation.■