2.3042

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, CHANCERY DIVISION

ACUITY,)
)
Plaintiff,)
)
v.) No. 15 CH 14113
)
STATE MECHANICAL SERVICES, L.L.C., and)
SELECTIVE INSURANCE COMPANY)
OF SOUTH CAROLINA,)
)
Defendants.)

MEMORANDUM OPINION AND ORDER

This insurance coverage dispute arises out of a lawsuit by Chicago Hotel Holdings, Inc. ("CHH"), the owner of the Millennium Knickerbocker Hotel Chicago ("Knickerbocker"), alleging defective retro-commissioning of individual fan coil units ("FCUs") in each of the Knickerbocker's guestrooms.[1] Selective Insurance Company of South Carolina ("Selective") defended the third party defendant, State Mechanical Services, L.L.C. ("State Mechanical"), in that suit, and eventually settled the claim against State Mechanical. Selective then sought reimbursement from the plaintiff, Acuity, which insured State Mechanical in the year after State Mechanical's policy with Selective expired. Acuity's present declaratory judgment action followed.

I. UNCONTESTED FACTS

In 2008, CHH hired Leopardo Companies, Inc. ("Leopardo") as the general contractor for a major renovation of the Knickerbocker that included, among other things, installation of new

[1] Unlike a central heating and cooling system that moves warm and cold air to rooms through ductwork, an FCU is a stand-alone unit with a coil and fan that is used to heat and cool an individual room without ductwork.

FCUs, drywall, fixtures, and finishes in each guestroom.[2] Between 2009 and 2011, the FCUs required servicing on multiple occasions. In 2011, after CHH informed Leopardo that the FCUs were malfunctioning and causing water to leak from guestroom ceilings, Leopardo hired State Mechanical to retro-commission the FCUs, a solution Leopardo anticipated would solve the FCU water leakage issues.[3] However, State Mechanical's retro-commissioning of the FCUs failed, and water continued to leak from guestroom ceilings, damaging the interior of the guestrooms, including their fit and finishes.

In May 2014, CHH filed an amended complaint in the Circuit Court of Cook County against Leopardo and two other companies that worked on the Knickerbocker renovation project. Count II alleged that Leopardo breached its contract with CHH by failing to properly install and repair the FCUs. Leopardo filed a second amended third-party complaint against State Mechanical, alleging that State Mechanical breached its contract with Leopardo by defectively performing the retro-commission work, and seeking indemnification for any liability it incurred as a result of that work ("Underlying Complaint"). Selective, with whom State Mechanical held a commercial general liability ("CGL") insurance policy for the period February 1, 2011 to February 2, 2012, defended State Mechanical and eventually paid CHH an unspecified amount to settle all claims against State Mechanical. Selective then sought reimbursement from Acuity, State Mechanical's CGL insurer for the period February 2, 2012 to February 1, 2013, because the Knickerbocker's guestrooms continued to experience water damage from 2012 to 2014. In response, Acuity filed this two-count complaint seeking declarations that it neither had a duty to defend or indemnify State Mechanical in the Underlying Lawsuit, nor an obligation to reimburse

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[2] It is not clear whether Leopardo or a subcontractor installed the FCUs, but it is undisputed that Leopardo was ultimately responsible for their installation.

[3] Leopardo originally purchased the FCUs from State Mechanical, but it is unclear whether State Mechanical performed any work on the FCUs prior to its retro-commissioning work.

Selective for monies expended in defending State Mechanical. Selective counterclaimed seeking a declaration that Acuity had a duty to defend and indemnify State Mechanical, and seeking equitable contribution for the costs it incurred in doing so.

The parties now cross-move for judgment on the pleadings. Acuity seeks a judgment in its favor on the basis that the Underlying Complaint does not allege an occurrence or property damage, and because coverage is barred under a policy exclusion. Selective contends otherwise in its cross-motion for partial judgment on the pleadings.

II. DISCUSSION

Judgment on the pleadings is proper if the pleadings disclose no genuine issue of material fact and that the movant is entitled to judgment as a matter of law. *Pekin Ins. Co. v. Wilson*, 237 Ill. 2d 446, 455 (2010). For purposes of resolving a motion for judgment on the pleadings, the court must construe all well-pleaded facts set forth in the pleadings, and the reasonable inferences drawn therefrom, in favor of the nonmoving party. *Id.* In a declaratory action, where the issue is whether the insurer has a duty to defend, a court ordinarily looks first to the allegations in the underlying complaint and compares those allegations to the relevant provisions of the insurance policy. *Id.* If the facts alleged in the underlying complaint fall within, or potentially within, the policy's coverage, the insurer's duty to defend arises. *Id.*

When construing an insurance policy, the Court must ascertain and enforce the intentions of the parties as expressed in the agreement. *Crum & Forster Managers Corp. v. Resolution Tr. Corp.*, 156 Ill. 2d 384, 391 (1993). To ascertain the intent of the parties and the meaning of the words used in the insurance policy, the court must construe the policy as a whole, taking into account the type of insurance for which the parties have contracted, the risks undertaken and purchased, the subject matter that is insured and the purposes of the entire contract. *Id.*

Unambiguous words must be afforded their plain, ordinary, and popular meaning, but words that are susceptible to more than one reasonable interpretation must be construed in favor of the insured and against the insurer that drafted the policy. *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 154 Ill. 2d 90, 108 (1992). In comparing the allegations of the underlying complaint to the terms of the policy, a court must give the policy and the complaint a liberal construction in favor of the insured. *Id.* at 109. Generally, the insured bears the burden of proving the claim is covered under a policy's grant of coverage, and the insurer bears the burden of proving an exclusion applies. *Addison Ins. Co. v. Fay*, 232 Ill. 2d 446, 454 (2009).

The Acuity policy provides coverage for "those sums that the insured becomes legally obligated to pay as damages because of . . . property damage to which this insurance applies." The policy only applies to property damage that is "caused by an occurrence." Thus, in order to decide whether Acuity had a duty to defend State Mechanical, the Court must first determine whether the Underlying Complaint alleges facts to establish an "occurrence." *See Viking Constr. Mgmt. v. Liberty Mut. Ins. Co.*, 358 Ill. App. 3d 34, 41-42 (1st. Dist. 2005). Once an occurrence has been established, then the Court must determine whether facts are alleged to establish "property damage." *Id.* If both are established, then the Court then must determine whether any exclusion applies. *Id.*

The Acuity policy defines an "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions," but does not define the term "accident." Acuity argues that "accident" means an "unforeseen occurrence, usually of an untoward or disastrous character or an undesigned, sudden, or unexpected event of an inflictive or unfortunate character." Despite the circular logic employed in defining an "occurrence" as an "accident," and an "accident" as an "unforeseen occurrence," courts have consistently applied

these definitions where the underlying plaintiff brings a claim based on faulty workmanship. *See Stoneridge Dev. Co. v. Essex Ins. Co.*, 382 Ill. App. 3d 731, 749 (2nd. Dist. 2008) (citing cases applying this definition to the term "accident" in a CGL policy). Under this definition, courts have determined that the "natural and ordinary consequences of an act do not constitute an accident." *Id.*

For example, in *Ind. Ins. Co. v. Hydra Corp.*, 245 Ill. App. 3d 926 (2nd. Dist. 1993), a building owner sued the construction company that built the building for breach of contract when the building's concrete floors cracked and exterior paint peeled off. *Id.* at 928. The court held that there was no occurrence because "the cracks in the floor and the loose paint on the exterior of the building are the natural and ordinary consequences of installing defective concrete flooring and applying the wrong type of paint." *Id.* at 930. Similarly, in *State Farm Fire & Cas. Co. v. Tillerson*, 334 Ill. App. 3d 404 (5th Dist. 2002), a homeowner brought a breach of contract claim against a construction company alleging that the company failed to properly compact the soil over a cistern before building a room addition and converting a carport into an enclosed garage, which resulted in uneven settling of the soil and damage to the room addition and garage. *Id.* at 406. The court found that there was no "occurrence" and, therefore, no duty to defend, because the damages alleged in the complaint were the natural and ordinary consequences of the construction company's improper construction techniques. *Id.* at 409. Likewise, in *Viking*, the underlying plaintiff brought a breach of contract claim alleging that a construction company's failure to adequately brace a masonry wall in a school construction project caused it to collapse, resulting in extensive property damage to a section of the school. *Viking*, 358 Ill. App. 3d at 45. The court stated that "the collapse of the wall and section of the building was the ordinary and natural consequence of improper bracing, *i.e.,* faulty construction work, which resulted from, at

least in part, [the contractor's] breach of its contractual duties to ensure proper construction methods were employed." *Id.* at 53. Because the damages alleged in the underlying complaint were the ordinary and natural consequences of the contractor's failure to perform its services in a workmanlike manner, there was no occurrence and, therefore, no duty to defend. *Id.* at 54. In so holding, the court stated, in *dicta*, that even if the insured alleged damage to other parts of the school, coverage would still not be triggered because the damage must be to something other than the school structure itself to qualify as an occurrence under a CGL policy. *Id.*

Here, the Underlying Complaint alleges that State Mechanical entered into a contract to re-commission the FCUs because they were leaking and causing water damage to the fit and finishes of guestrooms. It further alleges that State Mechanical breached the contract by failing to perform the re-commissioning work in a workmanlike manner. As a result, the FCUs continued to leak after State Mechanical's faulty work, and the ceilings, walls, and fit and finishes of the Knickerbocker's guestrooms continued to be damaged. This is nothing more than a claim to recover costs associated with repairing or replacing the natural and ordinary consequences of State Mechanical's defective work, which, under the rationale of the cases discussed above, does not qualify as an "occurrence" under a CGL policy. *See also Hartford Fire Ins. Co. v. Flex Membrane Int'l*, 2001 U.S. Dist. LEXIS 11700, at *5 (N.D. Ill. Aug. 1, 2001) (no duty to defend where underlying complaint alleged that insured's defective installation of roof caused water damage to building's interior because "the shattering and leaking of a roof are the natural and ordinary consequences of defective roof construction."); *Am. Fire & Cas. Co. v. Broeren Russo Constr.*, 54 F. Supp. 2d 842, 848 (C.D. Ill. 1999) (denying coverage where underlying complaint alleged that insured's defective installation of insulation system caused water infiltration that damaged interior of building because "it is inconceivable that the parties

would not have foreseen damage from water leaking into the building as a possible result of the failure of the System to prevent such leaking."); *Allied Prop. & Cas. Ins. Co. v. Metro N. Condo. Ass'n*, 2016 U.S. Dist. LEXIS 43952, at *20 (N.D. Ill. Mar. 31, 2016) (no duty to defend where underlying complaint alleged that insured's defective installation of windows caused water damage to common elements because "[w]hen a subcontractor who installs windows performs defective work, the natural and ordinary consequence is water infiltration that will damage the rest of the building. There is no accident, so there is no occurrence, so there is no coverage."), *aff'd*, 850 F.3d 844 (7th Cir. 2017).

Selective relies on a line of cases finding coverage under a CGL policy for damage to other property. *Cf. CMK Dev. Corp. v. W. Bend Mut. Ins. Co.*, 395 Ill. App. 3d 830, 831 (1st. Dist. 2009) ("This exception for damage to other property is not explicitly stated in the policy itself, but comes instead from the case law interpreting CGL policies.") Selective argues that in the cases that Acuity cites, the insured was the general contractor or developer whose responsibility extended to the entire construction project, not just part of it. Selective contends that where the insured is a subcontractor, as State Mechanical was here, coverage turns not on whether there is damage to something beyond the construction project itself, but on whether there is damage to something beyond the scope of the subcontractor's work. Therefore, according to Selective, when a subcontractor's defective work causes damage to other parts of the same construction project, there is coverage under a CGL policy.

But no Illinois court has held so expressly. Rather, Selective relies primarily on an undeveloped aspect of the court's opinion in *Milwaukee Mut. Ins. Co. v. J.P. Larsen, Inc.*, 2011 IL App (1st) 101316. There, a condominium association sued a contractor alleging breach of express and implied warranties. The contractor filed a third party complaint against the

subcontractor it hired to apply caulking and sealant to the windows that the contractor installed for contribution as a joint tortfeasor. *Id.* at ¶ 3. The underlying complaint alleged that the subcontractor's defective application of caulking and sealant allowed water to leak through the windows and "have and continue to cause damage to *the Condominium common elements, the units, and the individual unit owner's personal property.*" *Id.* at ¶ 12 (emphasis added). The court held that the insurer had a duty to defend because the underlying complaint alleged both an "occurrence" and "property damage," stating:

> In its third amended verified complaint, the PDH Association alleged the installation of a faulty window system resulted "in significant and continuing water leakage into the common elements and residential" units. Moreover, as previously discussed, the "property damage" that is, at least possibly, imputed to Larsen [subcontractor] through his negligent workmanship included personal property and water damage throughout a building not constructed by Larsen. Therefore, the underlying pleadings alleged that Larsen's negligent workmanship caused an accident in the form of significant and continuing water leakage. This is more than an allegation that the window sealant and caulking were defective. We, therefore, conclude that an "occurrence" was pled.

Id. at ¶ 28 (citations omitted). The court further stated:

> The costs described for the construction defects were between $4 million and $8 million. The costs associated with the "property damage" suffered by the individual unit owners was in addition to that sum, according to the complaint. The damages alleged are not intangible or merely associated with the repair or replacement of the faulty window caulking and sealant.

Id. at ¶ 21.

Nevertheless, *J.P. Larsen* did not frame the issue as Selective does here: whether a CGL policy provides coverage where a subcontractor's defective work on one part of a building causes damage to another part of the same building. At its core, *J.P. Larsen* is an unremarkable duty to defend for damage to personal property case, following the well-worn path in insurance declaratory judgment actions that "[i]f recovery is premised on several theories of liability, some of which are excluded from coverage, the insurer is still obligated to defend as long as one theory

might possibly fall within the scope of the policy coverage." 2011 IL App (1st) 101316 at ¶ 10. The underlying complaint in *J.P. Larsen* alleged that the insured's defective work caused damage to the personal property of unit owners, which, as the court found, triggers an insurer's duty to defend under a CGL policy. *See id.* at ¶ 27 (citing cases). *See also Westfield Ins. Co. v. West Van Buren, LLC*, 2016 IL App (1st) 140862, ¶ 18 (explaining that in *J.P. Larsen* "faulty window system that allegedly damaged *personal property* deemed possible occurrence") (emphasis added)). Therefore, to the extent that *J.P. Larsen* states or suggests that a duty to defend is triggered by allegations of damage to the common elements and individual units, parts of the building that the subcontractor did not work on, it was unnecessary to the disposition of the case and, therefore, dicta. And because there is no clear indication in the court's opinion that the parties argued that specific question, any such statements in that regard are obiter dicta, and not binding. *See People v. Williams*, 204 Ill. 2d 191, 206 (2003) (discussing difference between "obiter dicta," which is not binding, and "judicial dicta," which is). Further, *J.P. Larsen*, originally issued as a Rule 23 Order, 2011 Il App Unpub. LEXIS 1443 (June 20, 2011), would have been an unlikely case to announce and explicate coverage under a CGL policy for claims of damage beyond the subcontractor's scope of work where the damage allegations in the underlying complaint were so generic. *See id.* at ¶ 20 ("Although the damages to the common elements, individual units and personal property were not expressly described, we must construe the pleadings liberally to allow for coverage, or, at least, the potential for coverage."). Accordingly, this Court is loath to read *J.P. Larsen* beyond its core, and unremarkable, determination that there is a duty to defend under a CGL policy where the underlying complaint alleges damage to personal property.[4]

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[4] What would have been remarkable about *J.P. Larsen* is that the claim for damage to the personal property of unit owners was advanced by the condominium association, not the unit owners themselves,

As for its implication that "property damage" is established by an allegation of damage to property beyond what the insured worked on, *J.P. Larsen* cites *Pekin Ins. Co. v. Richard Marker Assocs.*, 289 Ill. App. 3d 819 (2d Dist. 1997). In *Richard Marker Assocs*, the underlying complaint alleged that water pipes burst causing damage to "carpeting, drywall, antique furniture, clothing, personal mementoes [sic in original] and pictures" because the insured architect failed to properly design the placement and insulation of plumbing pipes and exterior facing areas. *Id.* at 820. In finding that the underlying complaint triggered a duty to defend, the court stated, "the Yuans' complaint alleged: that faulty workmanship caused an accident in the form of continuous or repeated condensation which dripped and damaged furniture. This is more than an allegation that the building itself was defective. Although not mentioned by the parties, we also note that the Yuans' complaint alleged that they sustained damage to furniture, clothing and antiques when uninsulated pipes froze and burst." *Id.* at 823. Thus, while the underlying complaint alleged damage to parts of the building that the insured did not work on, the court did not ground a duty to defend on those damages. At most, *Richard Marker Assocs* stands for the proposition that damage to furniture and other personal property within the structure that the insured worked on constitutes "property damage" under a CGL policy. *See also Monticello Ins. Co. v. Wil-Freds Constr.*, 277 Ill. App. 3d 697, 705-706 (2nd. Dist. 1996) ("If, for example, Naperville had sued Wil-Freds for the water damage suffered by cars in the parking garage, or a pedestrian sued Wil-Freds for an injury caused by falling concrete, there can be little doubt that Monticello would be required to defend Wil-Freds under the CGL policy, because there would have been 'negligent manufacture that results in 'an occurrence.'' On the other hand, where the

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cf. Westfield Ins. Co. v. Nat'l Decorating Serv., 863 F.3d 690, 696 (7th Cir. 2017) (condominium association cannot recover for damage to unit owners' property), but the insurer apparently did not advance that argument.

only claim is one for a breach of contract alleging property damage to the project itself, we are faced merely with 'an occurrence of alleged negligent manufacture.'").[5] Here, because the Underlying Complaint only alleges damage to the hotel itself, not to any furniture or personal property inside the hotel, there is no occurrence or property damage under a CGL policy. *See* Tr. of Proc., Nov. 8, 2017, p. 35 (Selective agreeing that guest room fit and finishes are part of the hotel structure).

Selective also argues that the Underlying Complaint alleges an "accident" because there is no allegation that State Mechanical intended to cause the property damage. In essence, Selective argues that "accident" means an event that causes unintended property damage. In *Stoneridge*, the owners of a townhome sued the developer, alleging that the townhome was built on improperly compacted soil, compromising the townhome's structural integrity. *Stoneridge*, 382 Ill. App. 3d at 735. In a subsequent declaratory judgment action, the court considered

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[5] Two recent federal cases support Selective's position, but they rely on either *J.P. Larsen* or *Richard Marker Assocs*. One case, *Old Republic Ins. Co. v. Leopardo Cos., Inc., et al.*, involved the same FCU project at the Knickerbocker, but the insured was a different subcontractor. *Old Republic Ins. Co. v. Leopardo Cos., Inc., et al.*, No. 14 C 2421 (N.D. Ill. Mar. 11, 2015) (unreported). In finding a duty to defend, the court stated:

> The policy documents thus compel the conclusion that, in this case, the scope of work that determines whether the underlying complaint alleged "property damage" caused by an "occurrence" within the meaning of a CGL policy — *i.e.* damage to something other than the project itself — is Edwards' work, not Leopardo's. And since Edwards did not work on the "fit and finishes" of guestrooms . . . the underlying complaint plainly alleges damages to something other than the Edwards project itself, thereby triggering Old Republic's duty to defend.

Id. at 7. In *Nat'l Decorating Svc.*, the underlying complaint against the insured subcontractor alleged that by failing to apply an adequate coat of sealant to the exterior of a building, significant amounts of water leaked through the exterior concrete walls, balconies, and windows, causing damage to, among other things, the interior ceilings, floors, interior painting, drywall and furniture in the residential units. *Nat'l Decorating Svc., Inc.*, 863 F.3d at 692-93. The court, without much analysis, held that the underlying negligence complaint was sufficient to satisfy the occurrence requirement because the CGL policy defined it to mean not only an "accident," but also "continuous or repeated exposure to conditions," *id.* at 697, presumably referring to the water infiltration in the building. The court then went on to address whether the underlying complaint alleged "property damage," stating that "the relevant inquiry when determining the scope of a project is what the parties contracted for," and found that there was a duty to defend because the insured did not work on parts of the building that were damaged by water. *Id.* at 698. Thus, while *J.P. Larsen* considered damage to other parts of the project in determining if there was an "occurrence," *National Decorating* did so when considering whether there was "property damage."

whether an allegation that an insured did not intentionally cause property damage qualifies as an "accident." *Id.* at 750. The court acknowledged that "a strict application of this definition would seem to negate the previously-mentioned principle that an act's natural and ordinary consequences do not constitute an accident." *Id.* After reviewing relevant case law, the court explained that where there are no negligence claims and only breach of contract claims, "even if the person performing the act did not intend or expect the result, if the result is the 'rational and probable' consequence of the act or, stated differently, the 'natural and ordinary' consequence of the act it is not an 'accident.'" *Id.* at 751 (citation omitted). Thus, *Stoneridge* dispels the notion that the insured's intentions are determinative of coverage.

Selective articulates no principled reason why there should be coverage under a subcontractor's CGL policy but not under the general contractor or developer's same CGL policy. As Acuity points out, Selective's interpretation of the policy necessarily results in the coverage under a subcontractor's CGL policy being much broader than the coverage under a general contractor or developer's same CGL policies. The general contractor or developer would be covered as additional insureds under a subcontractor's CGL policy for the very same lawsuit and damages for which the general contractor or developer would not be covered under their own CGL policies.

Finally, a finding of no occurrence or property damage is consistent with the purpose of a CGL policy, which is intended:

> to protect the insured from liability for injury or damage to the persons or property of others; they are not intended to pay the costs associated with repairing or replacing the insured's defective work and products, which are purely economic losses. Finding coverage for the cost of replacing or repairing defective work would transform the policy into something akin to a performance bond.

Traveler's Ins. Co. v. Eljer Mfg., 197 Ill. 2d 278, 314 (2001) (quoting *Qualls v. Country Mut. Ins. Co.*, 123 Ill. App. 3d 831, 834 (4th. Dist. 1984)). A 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) (*quoting Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 249 (1979)). "Treating a CGL policy like a performance bond would be unjust to the CGL insurer, which, in contrast to the surety on a performance bond, cannot bring suit against the contractor for the defective construction." *Stoneridge*, 382 Ill. App. 3d at 749. Moreover, "if insurance proceeds could be used to pay for the repair or replacement of poorly constructed buildings, a contractor could receive initial payment for its work and then receive subsequent payment from the insurance company to repair or replace it." *Wil-Freds* 277 Ill. App. 3d 697 at 709.

The Court agrees with the federal district court's observation in *Metro N. Condo Ass'n* that while many of the cases involve general contractor insureds, rather than subcontractors whose defective work results in damage to other parts of the building, "this is a distinction without a difference because these cases do not turn on which portion of the building was damaged; rather, they turn on the principle that a construction defect is not an 'accident,' which Illinois courts have defined as "an event that is unforeseen and neither expected nor intended." 2016 U.S. Dist. LEXIS 43952, at *19-20 (citation omitted). *J.P. Larsen* and the cases it relies on do not carve out a different standard to be applied where the insured is a subcontractor whose defective workmanship causes damage to other parts of the building. Because the continuing water damage to fit and finishes of guestrooms alleged in the Underlying Complaint is the natural and ordinary consequences of State Mechanical's faulty workmanship, there is no occurrence or property damage within the meaning of a CGL policy. *See Acuity v. Lenny Szarek,*

Inc., 128 F.Supp. 3d 1053, 1062 (N.D. Ill. 2015) (no occurrence where underlying plaintiff alleged that carpenter subcontractor's defective workmanship caused water infiltration and damage to interior finishes of condominium units, and stating, "property damage due to construction defects is not caused by an 'occurrence' within the meaning of a CGL policy, regardless of whether the insured contractor is responsible for all or just a portion of the building itself.").

III. CONCLUSION

Acuity's motion is granted and Selective's motion is denied. Judgment on the pleadings is entered in favor of Acuity. The Court declares that Acuity did not have a duty to defend State Mechanical in the Underlying Complaint, does not have a duty to indemnify State Mechanical in the Underlying Complaint, and does not have an obligation to reimburse Selective for any amount it expended in defending and indemnifying State Mechanical.

Entered: