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Another Win for Policyholders as Illinois Reverses Course and Joins the Majority of States Recognizing CGL Policies Cover Property Damage Caused by Construction Defects

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On 30 November 2023, Illinois joined[1] the majority of states that recognize that commercial general liability (CGL) insurance covers damage to one part of a construction project caused by construction defects in other parts of the project, abrogating longstanding appellate authority requiring damage to something beyond the construction project itself to trigger coverage. The decision is the most recent in a series of high court decisions expanding the duty to defend construction defect actions and continues a positive trend for policyholders.[2]

In a unanimous decision, the Illinois Supreme Court held that property damage caused by inadvertent construction defects can be caused by an "accident" and may therefore constitute an "occurrence" triggering a policyholder's right to a defense.[3] In doing so, the court firmly rejected the argument that damage to a project caused by faulty workmanship can never be an "accident" because it is the "natural and probable risk of doing business."[4] This is an argument that many insurers rely on to disclaim their duty to defend against construction defect claims. This holding is a welcome win for real estate developers, general contractors, and commercial policyholders seeking insurance coverage for damage caused by the faulty work of their subcontractors.

The insurance coverage dispute arose in connection with a lawsuit filed by the homeowners association of a recently completed townhome development, Church Street Station Townhome Owners Association (the Association), against the developer of the townhome community, M/I Homes of Chicago, LLC (M/I Homes). The Association alleged that the townhomes were built with significant exterior defects (the faulty workmanship).[5] The Association sought damages for the repair or replacement of the faulty workmanship, which it alleged had also caused physical injury to the townhomes after they were completed.[6]

The insurer, Acuity, denied M/I Homes coverage for the lawsuit on the ground that the damages the Association sought were for faulty workmanship, not for "property damages" caused by an "occurrence" (i.e., an accident) as defined in the CGL policy. Acuity then commenced an action for a declaratory judgment that it did not have a duty to defend M/I Homes, relying on Illinois Court of Appeal cases holding that faulty workmanship is not an "accident" because it is the "natural and

ordinary consequence of" doing business. The trial court granted summary judgment in favor of Acuity holding that defective work can be covered only if it causes property damage to something other than the construction project.[7]

The appellate court reversed, relying on a different line of Illinois authority to hold that an insurer has the duty to defend if the faulty workmanship causes damage to work other than the defective work (e.g., the work of another subcontractor), even where the damaged property is a part of the same construction project. Relying on an allegation in the Association's complaint that "the work of subcontractors and the designer caused damage to other portions of the townhomes that was not the work of those subcontractors," the appellate court held that Acuity had a duty to defend M/I Homes under the CGL policy.[8]

On further appeal, the Supreme Court noted the "myriad of rationales and factors" that the lower courts had been using to determine whether damage due to faulty workmanship is an "occurrence" of "property damage" triggering an insurer's duty to defend.[9] The court observed that much of the case law was not "tied to the principles of contract interpretation but instead" to "various [public] policy considerations."[10] The court also acknowledged the concerns of many legal commentators that the status of the law in this area was "in chaos."[11]

The Supreme Court stressed a "return to first principles" and an application of "a disciplined legal framework from which we can arrive at the correct legal analysis." The court carefully restated the analysis broadly applicable to the interpretation of an insurance contract[12] and turned to the language of the coverage grant in the Acuity policy. The policy defined "property damage" as "physical injury to tangible property, including all resulting loss of use of that property."[13] Because the damage alleged by the Association—"water damage to the interior of units"—was "physical injury to tangible property" and the Association sought "to recover the cost of these resulting tangible damages on behalf of the townhome owners," the court determined that the Association sought "recovery for 'property damage' as that term is defined in the initial grant of coverage."[14] Critically, the court did not address whether the damage caused by the alleged faulty workmanship was damage to something other than the project or damage to "other work."

The court then turned to the definition of "occurrence" in the policy—"an accident, including continuous or repeated exposure to substantially the same general harmful conditions."[15] The court reasoned that an "'accident' encompasses the unintended and unexpected harm caused by negligent conduct." The court held that because "[n]either the cause of the harm—the inadvertent defects—nor the harm—the resulting water damage to the walls of the interior of the units—was intended, anticipated, or expected," the damage was an "accident."[16]

The court firmly rejected the rule created in the lower courts "that damage to any portion of the completed project caused by faulty workmanship categorically can never be caused by an accident because it is always the natural and probable risk of doing business."[17] It reasoned that "[t]o hold that all construction defects that result in property damage to the completed project are always excluded would mean that the exclusions in the policy related to business risk become meaningless"[18] and remanded the matter back to the trial court to determine whether the policy exclusions for "damage to your work" and "damage to your property" applied.[19]

Because insurers have the burden to demonstrate that coverage exclusions apply, the Supreme Court's decision in *M/I Homes* requires insurers to demonstrate that there is no allegation that construction defects caused damage to other parts of a project or to third-party property to avoid their duty to defend. A construction defect complaint containing allegations that defects caused damage to

other parts of a construction project or third-party property, even if nonspecific, should trigger an insurer's duty to defend in Illinois.

Real-estate developers and general contractors should carefully examine the allegations in a construction lawsuit for broad allegations of property damage that might trigger insurance coverage. Because construction litigation can be expensive to defend, insurer funding of the defense can be crucial to a successful resolution. Experienced policyholder counsel can help to assess a claim and advocate for coverage and, as necessary, litigate to maximize potential insurance recovery.

FOOTNOTES

[1] Acuity v. M/I Homes of Chicago, LLC, --- N.E.3d ----, 2023 IL 129087 (Ill. Nov. 30, 2023).

[2] *See*, e.g., Cypress Point Condo. Ass'n, Inc. v. Adria Towers L.L.C., 226 N.J. 403 (N.J. 2016); Owners Ins. Co. v. Jim Carr Homebuilder, LLC, 157 So. 3d 148 (Ala. 2014); Fejes v. Alaska Ins. Co., 984 P.2d 519 (Alaska 1999); Desert Mountain Props. Ltd. P'ship v. Liberty Mut. Fire Ins. Co., 250 P.3d 196 (Ariz. 2011); Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 67 A.3d 961 (Conn. 2013); Taylor Morrison Servs., Inc. v. HDI-Gerling Am. Ins. Co., 746 S.E.2d 587 (Ga. 2013); Sheehan Const. Co. v. Cont'l Cas. Co., 938 N.E.2d 685 (Ind. 2010); Nat'l Sur. Corp. v. Westlake Invs., LLC, 880 N.W.2d 724 (Iowa 2016); Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co., 137 P.3d 486 (Kan. 2006); Peerless Ins. Co. v. Brennon, 564 A.2d 383 (Me. 1989); Ohio Cas. Ins. Co. v. Terrace Enters., Inc., 260 N.W.2d 450 (Minn. 1977); Drake-Williams Steel, Inc. v. Cont'l Cas. Co., 883 N.W.2d 60 (Neb. 2016); High Country Assocs. v. New Hampshire Ins. Co., 648 A.2d 474 (N.H. 1994); Dodson v. St. Paul Ins. Co., 812 P.2d 372 (Okla. 1991); Harleysville Grp. Ins., Corp. v. Heritage Cmtys., Inc., 803 S.E.2d 288 (S.C. 2017); Owners Ins. Co. v. Tibke Constr., Inc., 901 N.W.2d 80 (S.D. 2017); Travelers Indem. Co. of Am. v. Moore & Assocs., Inc., 216 S.W.3d 302 (Tenn. 2007); Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007); Cherrington v. Erie Ins. Prop. & Cas. Co., 745 S.E.2d 508 (W. Va. 2013); Am. Fam. Mut. Ins. Co. v. Am. Girl, Inc., 673 N.W.2d 65 (Wis. 2004); *see also* Peerless Indem. Ins. Co. v. Colclasure, Civil Action No. 16-CV-424-WJM-CBS, 2017 WL 633046, at *1 (D. Colo. Feb. 16, 2017) (citing Colo. Rev. Stat. 13-20-808 (2010)).

[3] *M/I Homes*, 2023 IL 129087, ¶ 51.

[4] *Id*., ¶¶ 49–50.

[5] Acuity v. M/I Homes of Chicago, LLC, Civil Action No. 19 CH 237, 2021 WL 3825661, at *1 (Ill. Cir. Ct. July 30, 2021).

[6] *M/I Homes*, 2023 IL 129087, ¶ 5.

[7] Acuity, 2021 WL 3825661, at *5.

[8] *Acuity v. M/I Homes*, 205 N.E.3d 174, 183 (Ill. App. Ct. 2022).

[9] *M/I Homes*, 2023 IL 129087, ¶¶ 23?25.

[10] *Id*., ¶ 25.

[11] *Id*.

[12] *Id*., ¶¶ 26?33.

[13] *Id*., ¶¶ 37?38.

[14] *Id*., ¶ 39.

[15] *Id*., ¶ 47.

[16] *Id*., ¶ 48.

[17] *Id*., ¶ 49.

[18]*Id*., ¶ 50.

[19] *Id*., ¶¶ 58?67.

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