



In a landmark decision, the Illinois Supreme Court has granted a major victory for policyholders seeking general liability insurance coverage for construction defect and faulty workmanship claims. For years, Illinois' intermediate appellate courts rewrote general liability policies to eviscerate coverage for owners, developers, builders, general contractors, and subcontractors facing construction defect or faulty workmanship claims because those courts would only find the "property damage" or "occurrence" needed to trigger general liability policies if the damage went beyond the scope of the project. The Illinois Supreme Court had not touched the issue until last week. In a victory for insureds and common sense, the court has now eliminated the "scope of work" rule.

**The Ruling: Ending the "Scope of Work" Limitation on Defect Claims**

In *Acuity v. M/I Homes of Chicago*, the Illinois Supreme Court overturned years of lower court precedent and established that "property damage" in the context of construction defect or faulty workmanship claims exists **regardless of the scope of the project** so long as there is a "physical injury to tangible property, including all resulting loss of use of that property." The court defined "physical injury" to mean that the property was "altered in appearance, shape, color or in other material dimension."

The court also established that an "occurrence" in the defect or workmanship context **does not** require an allegation that the defect or workmanship caused damage to something outside of the insured's scope of work. In so holding, the court explicitly rejected years of insurer-friendly lower court rulings, concluding that "property damage that results from inadvertent faulty work can be caused by an 'accident' and therefore constitute[s] an 'occurrence' for purposes of the initial grant of coverage under the insuring agreement."

## **The Facts of the Case**

This case stems from an insurance coverage dispute tied to an underlying lawsuit alleging construction defects in a residential townhome development in the village of Hanover Park, Illinois. In this case, the townhome homeowners' association sued the general contractor for breach of contract and implied warranty of habitability arising from alleged construction defects that purported to cause water leakage and other physical damage to the townhome units. The general contractor (in accordance with best practices) sought coverage and demanded a defense as an additional insured under a general liability policy issued to a subcontractor. The subcontractor's insurer denied coverage for the underlying association lawsuit, leading to this action.

The general contractor argued that the alleged defects that were the subject of the underlying association lawsuit triggered at least a potential for coverage under the insurer's policy because the allegations, if true, constituted "property damage" caused by an "occurrence" under the policy. The insurer disagreed, arguing that any alleged physical damages were simply the natural and ordinary consequence of defectively performed work, rather than an "occurrence," which was defined by the policy as an accident. The trial court sided with the insurer, holding that under Illinois intermediate appellate case law, there could be no "property damage" caused by an "occurrence" unless the association alleged in the underlying suit that the contractor's wrongful conduct led to property damage outside the scope of the contractor's work (i.e., the construction project). The appellate court reversed the decision, finding that existing case law does not adhere to principles of contract interpretation and is inconsistent with similar cases throughout the country.

## **The Court's Analysis**

The Illinois Supreme Court sided with the general contractor and affirmed the appellate court. First, the court held that there was "property damage" under the plain language of the policy. The term "property damage" was defined by the policy to mean "physical injury to tangible property, including all resulting loss of use of that property." Under Illinois case law, a "physical injury" means alteration in the appearance, shape, color, or in other material dimension. Based on this definition, the court held that water damage to the townhome units "plainly constitutes" property damage.

Second, the court held that there was also an "occurrence," which was defined by the policy to mean "accident, including continuous or repeated exposure to substantially the same general harmful conditions." The court looked to various sources in concluding that "accident" means an unintended or unexpected result through carelessness, unawareness, or ignorance. Because the subcontractors did not "intentionally" perform substandard work, the court held that the construction defects and water damage constituted an accident, or an "occurrence," thereby triggering the duty to defend. The court then remanded the case to determine whether certain policy

exclusions related to business risks apply to preclude coverage, which the parties did not address on appeal.

## **What This Means for Policyholders and What To Do Next**

At bottom, the *Acuity* decision means that under many insurance policies with similar provisions—most of which are industry standard for general liability policies—insurers now owe a duty to defend and indemnify Illinois policyholders when construction defects or faulty workmanship cause physical damage within the scope of the construction project, unless a policy exclusion applies. This represents a sea change for Illinois owners, developers, builders, general contractors, and subcontractors, bringing the state in line with many other jurisdictions to provide the construction general liability coverage for which policyholders bargained.

Illinois has a 10-year statute of limitations for a breach of an insurance policy. **Businesses that have faced construction defect or similar claims and received a general liability insurance denial in the last 10 years based on the now-defunct "scope of work" rule should review the coverage denial letters and reengage with their insurance carriers.** Perkins Coie's Insurance Recovery practice comprises lawyers with years of experience resolving (and, if necessary, litigating) these types of claims and can assist affected parties in making a long-sought-after recovery of their defense expenses and any indemnity paid to the underlying plaintiff(s).

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