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Practice Group:

Insurance Coverage

Pennsylvania Appeals Court Confirms Insurance Coverage for Product Liabilities and Distinguishes “Faulty Workmanship”

By Joseph C. Safar and Kimberly L. Karr

Whether a construction defect constitutes a covered “occurrence” under a commercial general liability (“CGL”) policy has been the subject of a national debate among state courts in recent years. Armed with a small minority of seemingly pro-insurer decisions finding no coverage for a contractor’s “faulty workmanship,” some insurers have sought to broaden the coverage-divesting implications of such cases by arguing that the defective design or manufacturing of products should also be deemed “faulty workmanship,” and thus, not covered. This expansive view of what constitutes “faulty workmanship” disregards important distinctions made in earlier cases and significantly degrades, if not completely undermines, the broad products liability coverage commonly recognized to exist under CGL policies. For example, if taken to its logical conclusion, this would mean that product manufacturers whose off-the-shelf products unexpectedly cause property damage or bodily injury to others would not be able to obtain coverage—thereby defeating the very purpose of securing CGL coverage.

Significantly, on December 3, 2013, the Superior Court of Pennsylvania—an intermediate appellate court—rejected an insurer’s attempt to expand “faulty workmanship” into the products liability arena in *Indalex Inc. v. National Union Fire Insurance Company of Pittsburgh*, No. 612 WDA 2012 (Pa. Super. Ct. 2013). Specifically, the Superior Court of Pennsylvania held (i) that *Kvaerner* (Pennsylvania’s leading “faulty workmanship” case) and its progeny do not apply to claims alleging that an off-the-shelf product failed in service causing damage to other property and/or personal injury; and (ii) that Pennsylvania’s “gist of the action” doctrine, which recasts claims pleaded in tort as contractual, should not be applied in insurance coverage litigation to defeat an insurer’s duty to defend. *Indalex* represents a significant victory for policyholders in halting the expansion of Pennsylvania’s coverage-divesting “faulty workmanship” cases.

K&L Gates lawyers represented Indalex, the successful party in the appeal.

Background

Indalex Inc. and Harland Clarke Holdings Corp. (collectively, “Indalex”) sought coverage for liabilities related to allegedly defective “BetterBilt” windows and doors. In out-of-state lawsuits that spanned across five states, contractors and homeowners alleged that BetterBilt windows and doors leaked, resulting in physical damage to surrounding structures, like mold, mildew, and cracked walls, and in personal injuries. The complaints pleaded tort-based product liability theories, based on allegedly defective design and/or manufacturing, as well as breach of warranty.

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After Indalex exhausted its primary CGL coverage, it turned to its umbrella insurer, National Union Fire Insurance Company of Pittsburgh (“National Union”). The National Union umbrella policy provided defense and indemnification against third-party claims for bodily injury and/or property damage caused by an “occurrence.” The policy defined an occurrence as an “accident, including continuous or repeated exposure to conditions” resulting in injury or damage that is “neither expected nor intended from the standpoint of the insured.”

When National Union failed to provide coverage, Indalex sued for breach of contract. The trial court granted National Union’s motion for summary judgment, holding that the underlying claims against Indalex did not allege an “occurrence.”

Superior Court Decision

On December 3, 2013, the Superior Court reversed and remanded the trial court’s ruling in favor of National Union. First, the Superior Court rejected the trial court’s application of *Kvaerner* and its progeny as an improper extension of the “faulty workmanship” doctrine into the product liability arena. Second, the Superior Court rejected the trial court’s apparent reliance on the “gist of the action” when evaluating the duty to defend.

The Superior Court first addressed the lower court’s misapplication of *Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Insurance Co.*, 908 A.2d 888 (Pa. 2006). In *Kvaerner*, a contractor (Kvaerner) agreed to design and build a coke oven battery that subsequently failed and damaged itself. Kvaerner sought coverage under its CGL policy. The Supreme Court of Pennsylvania, however, ruled there was no coverage because the purely contractual claims asserted against Kvaerner for damage only to the battery itself did not constitute an “occurrence.” The policy at issue defined occurrence as an “accident,” which the Supreme Court interpreted as requiring a “fortuitous” event. The Supreme Court held that purely contractual claims based on “faulty workmanship” resulting in damage to the contractor’s own product lack “fortuity,” and thus, do not allege an “occurrence.”

The Superior Court held that the *Indalex* case was different, and the physical damage allegedly caused by Indalex’s windows and doors did constitute an “occurrence.” The alleged physical damage was not confined to the products themselves, but affected walls and other areas into which the product was installed. Thus, the court reasoned, *Kvaerner* did not apply. The Superior Court also refused to extend *Kvaerner* and its progeny into the products liability arena, distinguishing between claims alleging failure in service by a defective off-the-shelf product and claims alleging “faulty workmanship” by a contractor. In doing so, the Superior Court distinguished and clarified its two prior decisions in *Erie Insurance Exchange v. Abbott Furnace Co.*, 972 A.2d 1232 (Pa. Super. Ct. 2009) and *Millers Capital Ins. Co. v. Gambone Bros. Development Co., Inc.*, 941 A.2d 706 (Pa. Super. Ct. 2007)—cases that insurers have previously relied upon in an attempt to broaden *Kvaerner*’s holding. *Gambone* was distinguishable because it involved a contractor, not a product manufacturer; like *Kvaerner*, the damage from “faulty workmanship” was to the contractor’s own work product, the home. *Abbott Furnace* was distinguishable because the tort claims in that case were not properly pleaded.

The Superior Court next rejected the application of the “gist of the action” doctrine in the insurance coverage context. Under Pennsylvania law, a court may (under certain

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circumstances)¹ foreclose a party’s tort claims if the true “gist of the action” arises from contractual obligations between the parties. This prevents a claimant from circumventing a contract’s liquidated damages provision or receiving duplicative damages in both contract and tort.

When evaluating National Union’s duty to defend, the trial court had seemingly relied on the “gist of the action” doctrine to characterize tort claims pleaded in the underlying lawsuits. But the Superior Court held that such use of the “gist of the action” doctrine in the insurance coverage context is inconsistent with an insurer’s broad duty to defend, which includes an obligation to defend an entire lawsuit against the insured if one claim comes potentially within the policy’s coverage. Judicial recasting of tort claims as contract claims in order to relieve an insurer of its duty to defend is inconsistent with the insurer’s duty to defend all potential claims until it is clear that the underlying plaintiff cannot recover on any potentially covered claims. The Superior Court further noted that the Supreme Court of Pennsylvania has never adopted the “gist of the action” doctrine in an insurance coverage case.

What This Means for Pennsylvania Insurance Coverage Law

- **Confirmation of coverage for off-the-shelf product manufacturers.** By limiting *Kvaerner* to its particular facts, and distinguishing *Gambone* and *Abbott Furnace*, the Superior Court distinguished the *Kvaerner* “faulty workmanship” analysis from claims brought against product manufacturers for allegedly defective off-the-shelf products. As a result, insurers can no longer rely upon *Kvaerner* to deny coverage to manufacturers for product defect claims.
- **Confirmation of an insurer’s broad duty to defend.** The Superior Court’s rejection of the “gist of the action” in the insurance coverage context confirms that an insurer’s duty to defend is broad, applying even if a single claim is only potentially covered, and ensures that insurers cannot rely on the “gist of the action” doctrine to refuse coverage for so-called “mixed” claims.

Thus, *Indalex* represents an important victory for policyholders in halting the expansion of Pennsylvania’s coverage-divesting “faulty workmanship” cases into the products liability arena. The extent to which *Indalex* may assist Pennsylvania policyholders facing more traditional construction defect liabilities, and particularly those involving damage to other property, remains to be seen.

¹ The “gist of the action” doctrine forecloses tort claims “(1) arising solely from the contractual relationship between the parties; (2) when the alleged duties breached were grounded in the contract itself; (3) where any liability stems from the contract; and (4) when the tort claim essentially duplicates the breach of contract claim or where the success of the tort claim is dependent on the success of the breach of contract claim.” *Reardon v. Allegheny College*, 926 A.2d 477 (Pa. Super. Ct. 2007).

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Authors:

Joseph C. Safar

joseph.safar@klgates.com

+1.412.355.6443

Kimberly L. Karr

kimberly.karr@klgates.com

+1.412.355.7440

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