7

Construction Defect Claims

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7-1 INTRODUCTION

Roof leaks, water intrusion, toxic mold, structural failure—any number of these problems arising during or after the completion of construction on a project can give rise to claims for defective construction or faulty repair work. These claims can take many forms, and by virtue of the fact that they often are not discovered until some period of time after completion of the overall project, can include consequent damage to other parts of the project, equipment, inventory, or even the ability of that project to generate revenue. There are two general groups that may suffer loss as a result of a construction defect—the project owner, who likely is in contractual privity with at least some of those responsible for the defect, and third parties (other contractors, building tenants) who likely do not have any direct contractual right to recover as against those responsible for the defect. The rights and remedies of those two groups are different. This chapter provides an overview, with separate emphasis where appropriate for those two general groups, of construction defect litigation including (1) the theories of recovery, (2) the limitations on that recovery, (3) the damages available, and (4) insurance issues that are likely to arise and that must be taken into consideration in any construction defect case.

7-2 THEORIES OF RECOVERY

Construction defect claims may take a variety of forms, including, but not limited to, breach of contract, breach of warranty, negligence, fraud, and negligent misrepresentation cases. Invariably, a project owner will have one or more prime contracts for the construction of a project, making contract-based claims the predominant means to assert claims. Conversely, third parties suffering a loss as a result of a construction defect usually do not possess a contract-based claim, but may be able to pursue a tort-based remedy.

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7-2.1 Contract-Based Claims

7-2.1.1 Breach of Contract

In Pennsylvania, three elements are necessary to properly plead a cause of action for breach of contract: (1) the existence of a contract, including its essential terms, (2) a breach of a duty owed by the contract, and (3) resultant damages. *Church v. Tentarelli*, 953 A.2d 804 (Pa.Super. 2008); *Millers Capital Ins. Co. v. Gambone Bros. Dev. Co.*, 941 A.2d 706 (Pa.Super. 2007); *Kvaerner Metals Div. of Kvaerner United States, Inc. v. Commercial Union Ins. Co.,* 908 A.2d 888 (Pa. 2006); *Pittsburgh Constr. Co. v. Griffith*, 834 A.2d 572 (Pa.Super. 2003). Because of the gist-of-the-action doctrine, discussed in further detail in section 7-3.3, below, owners may be limited to this cause of action when suing those with whom they have a direct contract.

7-2.1.2 Breach of Warranty

Breach-of-express-warranty claims are closely related to breach-of-contract claims and will be governed by the terms of the express warranty. However, contractors may also be liable under an implied warranty of habitability or an implied warranty of reasonable workmanship for residential construction. *Elderkin v. Gaster*, 288 A.2d 771 (Pa. 1972). Pennsylvania courts have refused to establish one set standard for determining habitability or reasonable workmanship, but have found the implied warranties to have been breached in cases in which homes could not be used for their intended purpose because of major structural defects, water intrusion, or lack of potable water. Id.

The implied warranties of habitability and reasonable workmanship should be distinguished from the implied warranties of merchantability and fitness for a particular purpose under the Uniform Commercial Code (UCC). For the latter to apply, there must be a sale of "goods." Construction materials incorporated into a structure, although once a "good" under the UCC, may lose that quality and instead become a fixture. *Blocker v. City of Philadelphia*, 763 A.2d 373, 375 (Pa. 2000). Pennsylvania courts have specifically held that contracts for construction of residential homes and commercial real estate are not contracts for the sale of goods governed by the UCC. See, generally, *Romeo & Sons, Inc. v. P.C. Yezbak & Son, Inc.,* 617 A.2d 1320 (Pa.Super. 1992); *DeMatteo v. White*, 336 A.2d 355 (Pa.Super. 1975). Accordingly, an owner's ability to assert claims under the UCC will be limited unless it can demonstrate that the contract at issue was for the sale of goods and not a building or construction agreement with the furnishing of goods merely incident thereto. *DeMatteo,* 336 A.2d at 358.

7-2.2 Tort-Based Claims

7-2.2.1 Negligence

A cause of action in negligence requires allegations that establish the breach of a legally recognized duty or obligation that is causally connected to the damages suffered by the complainant. *Bilt-Rite Contractors, Inc. v. Architectural Studio*, 866 A.2d 270 (Pa. 2005). As discussed in more detail in sections 7-3.3 and 7-3.4, below, for those who have a contract with the entity responsible for a defect, the availability of negligence claims may be limited by the gist-of-the-action doctrine and, even when available, the types of damages recoverable under a negligence claim may be limited by the economic-loss doctrine.

7-2.2.2 Fraud

For a plaintiff to succeed on his or her claims of fraud in a construction defect case, he or she must prove six elements by clear and convincing evidence: (1) a representation, (2) that is material to the transaction at hand, (3) made falsely, with knowledge of its falsity or recklessness as to whether it is true or false, (4) with the intent of misleading another into relying on it, (5) where there was justifiable reliance on the misrepresentation, and (6) the resulting injury was proximately caused by the reliance. *Sewak v. Lockhart*, 699 A.2d 755, 759 (Pa.Super. 1997). Given these requirements, fraud claims will only arise in connection with construction projects under extraordinary circumstances, such as active concealment of a known, material defect. Id.

7-2.2.3 Negligent Misrepresentation

To successfully assert a claim for negligent misrepresentation under Pennsylvania law, a party must establish (1) a misrepresentation of material fact, (2) made under circumstances in which the misrepresenter ought to have known of the falsity, (3) with an intent to induce another to act on it, and (4) that results in injury to a party acting in justifiable reliance on the misrepresentation. *Tran v. Metropolitan Life Ins. Co.*, 408 F.3d 130, 135, n.8 (3d Cir. 2005) (citing *Bortz v. Noon*, 729 A.2d 555, 561 (Pa. 1999)).

A claim for negligent misrepresentation also requires the showing of a duty on the part of the party that allegedly made the misrepresentation. *Bortz v. Noon*, 729 A.2d 555, 561 (Pa. 1999) ("Moreover, like any action in negligence, there must be an existence of a duty owed by one party to another"). A duty can exist in the absence of a contractual relationship where a party in the business of supplying information, such as an architect or design professional, negligently supplies information where it is foreseeable that the information will be used and relied upon by third persons. *Bilt-Rite Contractors, Inc. v. Architectural Studio*, 866 A.2d 270, 287 (Pa. 2005); see also *Eastern Roofing Sys., Inc. v. Cestone,* 25 Pa.D.&C.5th 394, 416–17 (C.P. Lackawanna 2012).

In *Bilt-Rite*, the Supreme Court of Pennsylvania decided as an issue of first impression the question of whether a building contractor could maintain a negligent misrepresentation claim against an architect for alleged misrepresentation of the architect's plans for a public construction contract where there was no privity of contract between the architect and the contractor, but the contractor relied upon the plans and specifications submitted by the architect.

The court went through an extensive review of Pennsylvania case law, as well as similar cases from other jurisdictions, pertaining to the application of Restatement of Torts section 552 to the economic-loss rule. Succinctly stated, the court held:

> We are persuaded by these decisions from our sister jurisdictions that: (1) this Court should formally adopt Section 552 of the Restatement (Second), which we have cited with approval in the past, as applied by those jurisdictions in the architect/contractor scenario; (2) there is no requirement of privity in order to recover under Section 552; and (3) the economic loss rule does not bar recovery in such a case.

Id. at 479. As the court explained the application of section 552 to such cases:

> Section 552 sets forth the parameters of a duty owed when one supplies information to others, for one's own pecuniary gain, where one intends or knows that the information will be used by others in the course of their own business activities. The tort is narrowly tailored, as it applies only to those businesses which provide services and/or information that they know will be relied upon by third parties in their business endeavors, and it in-

> cludes a foreseeability requirement, thereby reasonably restricting the class of potential plaintiffs. The Section imposes a simple reasonable man standard upon the supplier of the information. As is demonstrated by the existing case law from Pennsylvania and other jurisdictions, and given the tenor of modern business practices with fewer generalists and more experts operating in the business world, business persons have found themselves in a position of increasing reliance upon the guidance of those possessing special expertise. Oftentimes, the party ultimately relying upon the specialized expertise has no direct contractual relationship with the expert supplier of information, and therefore, no contractual recourse if the supplier negligently misrepresents the information to another in privity. And yet, the supplier of the information is well aware that this third party exists (even if the supplier is unaware of his specific identity) and well knows that the information it has provided was to be relied upon by that party. Section 552 is not radical or revolutionary; reflecting modern business realities, it merely recognizes that it is reasonable to hold such professionals to a traditional duty of care for foreseeable harm.

Id. at 479–80. The court was satisfied that the adoption of section 552 was consistent with the court's traditional approach to tort duties. In sum:

- the profession is aware that the disseminated information will be provided to, and used by, others in their own business dealings;
- there is no reason to exempt professionals from the tort consequences of a negligent failure to perform the requisite services in a competent fashion;
- the limitations of section 552 account for the nature of the risk;
- the duty imposes the foreseeability of the protective harm;
- the consequences of imposing a duty upon such professional if he or she is unreasonable or unduly burdensome to the duties other professionals face; and
- the application of section 552 will promote the public interest by discouraging negligence among design professionals by not requiring any more of them than is required by the traditional reasonable man and foreseeability tort approach.

The court concluded:

> Accordingly, we hereby adopt Section 552 as the law in Pennsylvania in cases where information is negligently supplied by one in the business of supplying information, such as an architect or design professional, and where it is foreseeable that the information will be used and relied upon by third persons, even if the third parties have no direct contractual relationship with the supplier of information.

Id. at 482. Notwithstanding this apparent expansion of tort remedies by virtue of the decision in *Bilt-Rite Contractors*, Pennsylvania still retains a number of legal doctrines that often work to severely limit, or even bar, tort-based recovery in the typical scenario where the project owner has one or more contracts related to the construction at issue. Some of those limitations are discussed below.

7-3 LIMITATIONS ON RECOVERY

Even if a plaintiff is able to establish all of the elements of one or more of the above causes of action, recovery for construction defects may be limited or completely forestalled by, among other things, the statute of limitations, the statute of repose, the gist-of-the-action doctrine, or the economic-loss doctrine.

7-3.1 Statute of Limitations

The statute of limitations applicable to a construction defect case will depend to a large extent upon the nature of the cause of action asserted. For negligence, fraud, and negligent misrepresentation, the statute of limitations is two years. *Repasky v. Jeld-Wen, Inc.*, 81 Pa.D.&C.4th 495 (C.P. Adams 2006); *Gustine Uniontown Assocs., Ltd. v. Anthony Crane Rental, Inc.,* 892 A.2d 830 (Pa.Super. 2006). For breach-of-warranty claims, the statute of limitations is four years from the date the seller tendered delivery of the product. *Assumption of the Blessed Virgin Mary Church of the Archdiocese of Philadelphia v. PFS Corp.*, No. 1078, Commerce Program (C.P. Philadelphia June 18, 2002). Finally, the statute of limitations for breach of a written contract is four years unless there is another limitation that applies. 42 Pa.C.S. § 5525.

In the early 2000s, there were significant developments regarding the statute of limitations for cases involving breach of contract based upon a latent construction defect. For years, courts had held that such cases were subject to a six-year statute of limitations. See *Gustine Uniontown Assocs., Ltd. v. Anthony Crane Rental, Inc.,* 786 A.2d 246 (Pa.Super. 2001). In doing so, the courts were relying on the decision in *Romeo & Sons, Inc. v. P.C. Yezbak & Son, Inc.*, 652 A.2d 830 (Pa. 1995), which held that 42 Pa.C.S. § 5525 did not expressly include contracts for the sale or construction of real property, and thus the four-year statute of limitations did not apply. The *Romeo* court explained its reasoning for a more generous limitations period due to the difficulty in ascertaining presumptive responsibility for construction defects or failures, as well as inevitable delays that are involved in negotiations for performing attempts at remediation and repair. *Gustine*, 786 A.2d at 254 (citing *Romeo*). The Superior Court in *Gustine* stated that they agreed with the "policy principles and considerations of fairness and legal and ethical responsibilities set forth in *Romeo I* supporting application of a six-year statute of limitations" to actions arising from construction contracts. Id.

The Pennsylvania Supreme Court rejected the Superior Court's decision in *Gustine* and reversed the decision in 2004. *Gustine Uniontown Assocs., Ltd. v. Anthony Crane Rental, Inc.*, 842 A.2d 334 (Pa. 2004). The Supreme Court stated that the four-year statute of limitations for breaches of contract found in 42 Pa.C.S. § 5525(a)(8) applied to a contract for construction just as it did for other written contracts. In rejecting the Superior Court's decision, the Supreme Court stated that "absent ambiguity or constitutional infirmity, it is not the place of [the Pennsylvania Supreme Court] or the Superior Court to substitute its own balancing of equities in order to determine what limitations period is most 'fair.'" *Gustine,* 842 A.2d at 348. The Supreme Court concluded that section 5525(a)(8) is clear and unambiguous:

> [I]f the proviso concerning other limitations periods is not applicable, then the four-year rule set forth in 5525(a)(8) controls contract actions based upon a writing. This lawsuit . . . is just such a contract action and it is undisputed that there is no other specific statutory provision affording a longer period of limitations for actions upon real estate construction contracts, or latent defects in construction.

Id. at 347.

The applicable statute of limitations can be tolled in at least two ways, namely by application of the "discovery rule" or the "repair doctrine." The discovery rule is a judicially created equitable device that tolls the running of the applicable statute of limitations until the point where the complaining party knows or reasonably should know that he or she has been injured and that the injury has been caused by another party's conduct. The complaining party must use reasonable diligence to discover the cause of an injury. *Crouse v. Cyclops Industries,* 745 A.2d 606, 611 (Pa. 2000). The discovery rule has been expressly recognized as applicable in latent construction defect cases. *Gustine Uniontown Assocs., Ltd. v. Anthony Crane Rental, Inc.*, 842 A.2d 334, 344, n.8 (Pa. 2004); *Northampton County Area Community Coll. v. Dow Chemical, U.S.A.*, 566 A.2d 591, 598 (Pa.Super. 1989).

While the Pennsylvania Supreme Court has approved of the discovery rule, it has not definitively accepted or rejected the repair doctrine. That doctrine, however, has found considerable acceptance in the Superior Court. Under the repair doctrine, the applicable statute of limitations will be tolled where (1) the evidence reveals that repairs were attempted, (2) representations were made that the repairs would cure the defects, and (3) the complaining party relied upon such representations. *Amodeo v. Ryan Homes, Inc.*, 595 A.2d 1232, 1237 (Pa.Super. 1991) (adopting repair doctrine in Pennsylvania); see also *Keller v. Volkswagen of America, Inc.*, 733 A.2d 642, 646 (Pa.Super. 1999). While the doctrine was addressed by the Pennsylvania Supreme Court in *Gustine Uniontown Assocs., Ltd. v. Anthony Crane Rental, Inc.*, 842 A.2d 334 (Pa. 2004), it has never been formally adopted as the law in Pennsylvania.

7-3.2 Statute of Repose

In contrast to the statute of limitations, which limits the time in which a plaintiff may bring suit after a cause of action accrues, the statute of repose potentially bars a plaintiff's suit before the cause of action arises. *Vargo v. Koppers Co.*, 715 A.2d 423 (Pa. 1998). The Pennsylvania statute of repose is found at 42 Pa.C.S. § 5536(a) and serves as a substantive bar to any action brought more than 12 years after construction is completed. As defects sometimes do not become apparent until more than 12 years after the completion of construction, the statute of repose may serve as a strong defense to such claims.

42 Pa.C.S. § 5536 provides in pertinent part:

> [A] civil action or proceeding brought against any person lawfully performing or furnishing the design, planning, supervision or observation of construction, or construction of any improvement to real property must be commenced within 12 years after completion of construction of such improvement to recover damages for:
>
> (1) Any deficiency in the design, planning, supervision or observation of construction or construction of the improvement.
>
> (2) Injury to property, real or personal, arising out of any such deficiency.

The 12-year period begins to run when the entire construction project is so far completed that it can be used by the general public. *Catanzaro v. Wasco Products, Inc.*, 489 A.2d 262 (Pa.Super. 1985).

7-3.3 Gist-of-the-Action Doctrine

The gist-of-the-action doctrine precludes a party "from re-casting ordinary breach of contract claims into tort claims." *eToll, Inc. v. Elias/Savion Adver., Inc.*, 811 A.2d 10, 14 (Pa.Super. 2002). To prevent this, Pennsylvania courts have held that tort actions lie only for breaches of

duties that are imposed by law based on social policy, as opposed to breaches of duties imposed only by agreements between particular parties. Id. Put another way, "a claim should be limited to a contract claim when 'the parties' obligations are defined by the terms of the contracts, and not by the larger social policies embodied in the law of torts.'" *Bohler-Uddeholm America, Inc. v. Ellwood Group, Inc.*, 247 F.3d 79, 104 (3d Cir. 2001).

Pennsylvania courts have expressed the gist-of-the-action doctrine in a number of similar ways:

> These courts have held that the doctrine bars tort claims: (1) **"arising solely from a contract between the parties"** (*Galdieri [v. Monsanto Co.,]* 2002 U.S. Dist. LEXIS 11391 at *33) [E.D. Pa. May 7, 2002)]; (2) where **"the duties allegedly breached were created and grounded in the contract itself"** (*Werner Kamman [Maschinenfabrik, GmbH, v. Max Levy Autograph, Inc.],* 2002 U.S. Dist. LEXIS 1460 at *20), [E.D. Pa. 2002)]; (3) where **"the liability stems from a contract"** (*Asbury [Auto. Group LLC v. Chrysler Ins. Co.],* 2002 U.S. Dist. LEXIS at *10 [(E.D. Pa. January 7, 2002)]; or (4) where the tort claim **"essentially duplicates a breach of contract claim or the success of which is wholly dependent on the terms of a contract."** (*Polymer Dynamics, [Inc. v. Bayer Corp.],* 2000 U.S. Dist. LEXIS 11493 at *19 [(E.D. Pa. August 14, 2000.)].

eToll, 811 A.2d at 19 (emphasis added). In general, the "gist-of-the-action" test "is a general test concerned with the 'essential ground,' foundation, or material part of an entire 'formal complaint' or lawsuit." *eToll*, 811 A.2d at 15.

When a plaintiff alleges that the defendant committed a tort in the course of carrying out a contractual agreement, Pennsylvania courts examine the claim and determine whether the "gist" or gravamen of it sounds in contract or tort. *Erie Ins. Exch. v. Abbott Furnace Co.*, 972 A.2d 1232 (Pa.Super. 2009). The test is concerned with the nature of the action as a whole. Id. For example, in *Erie,* the plaintiff had ordered a furnace to be built and installed according to its specifications under a contract. The plaintiff alleged that the furnace malfunctioned and caused property damage, thus justifying a separate count for negligence. The court found that the case should be limited to one involving only a breach of contract because the parties' obligations were specifically defined by the terms of the contract, and not by the larger social policies embodied by law of torts. Id.

Similarly, in *Factory Market, Inc. v. Schuller International, Inc.,* 987 F.Supp. 387 (E.D. Pa. 1997), the court applied the "gist-of-the-action" doctrine to strike down a fraud claim. The case involved an allegedly defective roof. After the defendant made several attempts to repair it, the plaintiff brought suit alleging breach of contract, negligence, and fraud. The plaintiff argued that the defendant knew at the time of the agreement that the only way to make the roof watertight would be to replace the entire roof, but instead the defendant fraudulently agreed to a series of futile attempts to repair it. The court held that the plaintiff's fraud claims were barred by the gist-of-the-action doctrine, reasoning that the obligation to make the roof watertight was imposed by the contract, not in tort; and without the contract, the plaintiff would have no claim at all.

The gist-of-the-action doctrine is a substantial hurdle for any owner who is a party to a contract for the construction of a project where a defect is discovered.

7-3.4 Economic-Loss Doctrine

It is well-settled law in Pennsylvania that the economic-loss doctrine bars recovery in tort where there is no physical injury and the only damages are to the product itself. The general rule is that "economic losses may not be recovered in tort absent physical injury or other property dam-

age." *Repasky v. Jeld-Wen, Inc.*, 81 Pa.D.&C.4th 495, 498 (C.P. Adams 2006). There are very limited exceptions to this longstanding rule—most notably, the exception articulated by the court in *Bilt-Rite*.

What constitutes "other property damage" has been the subject of controversy in a number of Pennsylvania cases. To determine what constitutes damages to "other property" for purposes of the economic-loss doctrine, the "product" is considered to be the finished product rather than the individual components of which it is composed. *Repasky*, at 502 (citing *King v. Hilton-Davis*, 855 F.2d 1047, 1052 (3d Cir. 1988)). When a component of a structure is alleged to be defective, it is not considered "other property," and the economic-loss doctrine will bar the plaintiff from recovering under theory in tort. *Repasky,* at 502 (citing *Lupinski v. Heritage Homes, Ltd.*, 535 A.2d 656, 657–58 (Pa.Super. 1988)). For example, damages to a house that were allegedly caused by bug-infested lumber that was integrated into the house was determined not to be damage to "other property." *Lupinski v. Heritage Homes, Ltd.*, 535 A.2d 656, 657–58 (Pa.Super. 1988). Similarly, damage to a building façade caused by allegedly defective exterior wall coating was found not to be damage to "other" property, thereby limiting plaintiff's recovery to contract-based theories. *Wellsboro Hotel Co. v. Prins,* 894 F.Supp. 170, 175 (M.D. Pa. 1995).

When applied to the construction defect context, the economic-loss doctrine has operated to deny the recovery of purely economic damages based on the negligent design or construction of a project. For a number of years, architects and other design professionals routinely used the economic-loss doctrine to defeat the tort claims of third parties with whom they did not have a contract. See, e.g., *David Pflumm Paving & Excavating, Inc. v. Foundation Servs. Co.*, 816 A.2d 1164 (Pa.Super. 2003); *Linde Enters., Inc. v. Hazelton City Auth.*, 602 A.2d 897 (Pa.Super. 1992).

As discussed above, the Pennsylvania Supreme Court made a dramatic shift in the application of the economic-loss doctrine to the construction context in *Bilt-Rite Contractors, Inc. v. Architectural Studio*, 866 A.2d 270 (Pa. 2005). In that case, the court affirmed the ability of a building contractor to recover on a direct claim against an architect, despite the absence of contractual privity. The court also held that the economic-loss doctrine would not act as a bar to such recovery, thus creating an exception to the economic-loss doctrine for negligent misrepresentation cases.

In the wake of *Bilt-Rite*, most courts have been reluctant to expand the holding beyond its specific facts. See, e.g., *Vigilant Ins. Co. v. SPX Corp.*, Civil Action No. 06-23 (W.D. Pa. March 14, 2008) (refusing to apply *Bilt-Rite* in the products liability context); *Steinbrink v. Rothstein, Kass & Co., P.C.,* Civil No. 01-382 Erie (W.D. Pa. March 19, 2008) (refusing to apply *Bilt-Rite* to professional negligence claim). For now, Pennsylvania courts appear to view *Bilt-Rite* as a "narrow exception to the application of the economic loss rule . . . limited to design professionals, such as architects, because they have a contractual relationship with some party to the construction project, typically the owner, from which a duty flows to foreseeable third parties to that contract." *Excavation Techs., Inc. v. Columbia Gas Co.,* 936 A.2d 111, 116 (Pa.Super. 2007).

7-4 DAMAGES

The damages recoverable in a construction defect case will depend on the cause of action asserted by the plaintiff. In a breach-of-contract case, Pennsylvania law generally entitles an injured party to recover his or her expectation interest as measured by the loss in the value to him or her of the other party's performance caused by its failure or deficiency, plus any other loss, including incidental or consequential losses caused by the breach, less any cost or other loss that

he or she has avoided by not having to perform. *Cashman Equip. Corp. v. U.S. Fire Ins. Co.,* Civil Action No. 06-3259 (E.D. Pa. September 17, 2008). However, more specifically, the categories of damages to which an aggrieved party may be entitled are those enumerated in the contract covering the work. Commercial parties are free to expand or limit the types and amounts of damages to which they may be entitled by contract. Given the fact that a party under contract is likely precluded from a tort remedy for one or more of the reasons discussed above, the language of the contract under the which the defective work or materials is supplied is vital. For that reason, thought given to this issue before the project commences during the contract negotiation stage is likely to be more important than thought given after the problems have arisen.

For tort cases, the Pennsylvania Supreme Court has long held that the measure of damages for injury to land, where the land is reparable, is as follows: "damages are assessed according to the lesser of the cost of repair or the market value of the affected property." *Pennsylvania Dep't of Gen. Servs. v. U.S. Mineral Products Co.,* 898 A.2d 590, 595 (Pa. 2006) (negligence and strict liability action for property damage from PCB contamination). See also *Lobozzo v. Adam Eidemiller, Inc.*, 263 A.2d 432, 437 (Pa. 1970) (measure of damages to real property damaged by blasting was cost of repair, unless that cost would exceed the value of the building); *Evans v. Moffat,* 160 A.2d 465 (Pa.Super. 1960) (private nuisance case). If the harm to property is permanent, the plaintiff may recover "the diminution in market value attributable to the conduct." *U.S. Mineral,* above; see *Kirkbride v. Lisbon Contractors, Inc.*, 560 A.2d 809, 813 (Pa.Super. 1989) (no permanent injury to land from grading and clearing where no de facto "taking" and land was reparable). Diminution in the market value of the land is measured by the difference between what the property would have sold for as affected by the injury and what it would have brought unaffected by such injury. *Milan v. City of Bethlehem*, 94 A.2d 774, 776 (Pa. 1953).

The measure of damages for a destroyed building is the cost of repair (or restoration), unless such costs exceed the value of the building immediately before the tort. *Jones v. Monroe Electric Co.*, 39 A.2d 569 (Pa. 1944). If repair costs exceed the building's value, damages are calculated as the "actual value of the building itself, taking into consideration its age, condition and any other circumstances affecting it, and less anything salvaged from it." Id. at 571. Where a building was totally destroyed in a landslide but the land was not permanently injured, the plaintiff was awarded the value of the building at the time the slide began, rather than the difference in the value of the building. *Kosco v. Hachmeister, Inc.*, 152 A.2d 673, 676 (Pa. 1959). A plaintiff can recover the decrease in market value of property in addition to the cost to repair damaged property if the plaintiff can establish a permanent diminution in market value based on a prospective purchaser's fear of potential landslides. *Wade v. S.J. Groves & Sons Co.*, 424 A.2d 902 (Pa.Super. 1981).

The party seeking to obtain compensation for property damage has an obligation to establish that the repairs effectuated (or if the claim is of total destruction, the fact of the total loss) are fairly attributable to the defendant's conduct, product, or instrumentality giving rise to the liability. In other words, the plaintiff must prove that there was a defect in the product and that the defect caused the injury. *U.S. Mineral* and *Lobozzo,* above.

Further, tort damages generally include all losses flowing from the breach of a duty. As such, loss of use, lost profits, and other consequential damages may be properly recoverable.

7-5 INSURANCE CONSIDERATIONS

One issue of potentially great importance is whether a contractor responsible for a defect can obtain coverage for the damages through its general liability insurance policy. Questions regarding interpretation and what will be covered under the policies often arise in construction defect litigation.

In general, the purpose and intent of a general liability insurance policy is to protect the insured from liability for accidental injury to the person or property of another rather than to provide coverage for disputes between parties to a contractual undertaking. *Freestone v. New England Log Homes, Inc.*, 819 A.2d 550, 553 (Pa.Super. 2003) (citing *Redevelopment Auth. of Cambria County v. International Ins. Co.*, 685 A.2d 581 (Pa.Super. 1996)). Commercial general liability (CGL) policies often have language that provides that the insurer will pay the sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which the insurance applies. Many policies hold that the insurance only applies to "bodily injury" or "property damage" if the "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory." (See *Kvaerner Metals Div. of Kvaerner United States, Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 897 (Pa. 2006), for an example of language from a general liability insurance policy.) In addition, most CGL policies have exclusions for damage to the insured's property arising out of "your work," or work performed by the policyholder. Traditionally, however, CGL policies also contain a "give-back" provision that states that the "your work" exclusion does not apply if the damaged work or the work out of which the damage arises is performed on behalf of the policyholder by a subcontractor.

There has been significant controversy in Pennsylvania case law as to what constitutes an "occurrence" under general liability policies. The Supreme Court of Pennsylvania attempted to remedy this dilemma in 2006, with its decision in *Kvaerner*.

In that case, Bethlehem Steel brought suit against Kvaerner alleging that Kvaerner had installed a faulty coke oven battery. Kvaerner claimed that the problems were the result of a subcontractor grouting the roof of the oven prematurely followed by a subsequent "monsoon rain." Kvaerner sought indemnification and defense from its insurer, National Union, under the subcontractor "give-back" to the "your work" exclusion in its CGL policies.

National Union refused to defend and indemnify Kvaerner, stating that the policies were only meant to cover "accidental" damages, and National Union was not required to defend or indemnify an insured for breach-of-contract claims, presumably because damages resulting from a party's breach of contract could never be classified as "accidental."

The National Union CGL policies did not provide a definition for "accident." The court looked to Webster's II New College Dictionary, which defined "accident" as "an unexpected and undesirable event," or "something that occurs unexpectedly or unintentionally." The court stated that the key term in the ordinary definition of "accident" is "unexpected," and that an owner should expect that damage will result from faulty construction work. As a result, the court held that Kvaerner's faulty work (or that of its subcontractor) that led to the damage was not an accident and thus not an "occurrence" under the policy. Id. at 897–98.

The *Kvaerner* holding dictates that the question of coverage will be answered by the type of property that was damaged. Where faulty work causes bodily injury or damage to another property, the CGL policy likely will provide coverage. Where faulty workmanship damages the work product alone, the CGL policy probably will not apply. Id. at 898–99.

The Pennsylvania Superior Court reinforced the *Kvaerner* decision in *Millers Capital Insurance Co. v. Gambone Brothers Development Co.*, 941 A.2d 706 (Pa.Super. 2007). In that case, Gambone, the developer of two housing developments, was sued for faulty construction of the homes, including faulty exterior stucco. Gambone's insurer denied coverage under Gambone's CGL policy on the basis of the holding in *Kvaerner*. On appeal, Gambone tried to distinguish this case from *Kvaerner*, stating that this case involved an "occurrence" because in addition to claims for faulty workmanship of stucco exteriors there were also claims for ancillary and accidental damage caused by the resulting water leaks to nondefective work inside the home interiors. Gambone argued that the resulting water damage was an "occurrence."

The court rejected Gambone's arguments and held that the resulting water damage or "natural and foreseeable acts … which tend to exacerbate the damage, effect, or consequences caused *ab initio* by faulty workmanship also cannot be considered sufficiently fortuitous to constitute an 'occurrence' or 'accident' for the purposes of an occurrence based CGL policy." Id. at 713.

The court also rejected Gambone's secondary argument that the "occurrence" exclusions were meant to cover only work performed by the policyholder and not damage arising out of work performed on the policyholder's behalf by a subcontractor. The court strictly applied the *Kvaerner* rule in holding that faulty work, whether by the policyholder or its subcontractors, does not constitute an occurrence and is therefore not covered by the CGL policy. Id. at 715.

The court's holding in *Gambone* essentially does away with the subcontractor "give-back" in the "your work" exclusion, leaving general contractors vulnerable to coverage denials in most construction defect litigation in Pennsylvania. More recently, however, the Superior Court's decision in *Indalex Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA,* 83 A.3d 418 (Pa.Super. 2013), reflects a change in the court's approach to applying *Kvaerner*.

In *Indalex,* Indalex Inc. and Harland Clarke Holdings Corporation (collectively, "Indalex") sought coverage for contract- and tort-based claims asserted by multiple claimants in lawsuits filed in several different states alleging that the defective design of Indalex-manufactured windows and doors caused water leakage resulting in mold, cracked walls, and personal injury. After Indalex's primary coverage was exhausted, Indalex's excess carrier, National Union Fire Insurance Company ("National Union") denied coverage. In the ensuing coverage litigation, the trial court granted summary judgment in favor of National Union based upon the holding in *Kvaerner*. On appeal, the Superior Court reversed.

In reaching this decision, the Superior Court distinguished *Kvaerner, Gambone,* and their progeny on the basis that the claims against the insureds in those cases focused on allegations that faulty workmanship caused damage to the product itself, whereas the allegations in *Indalex,* were that an "off-the-shelf" product failed and caused property damage and personal injury. 83 A.3d at 423–24. The court also distinguished the definition of "occurrence" assessed in *Kvaerner* from the one appearing in National Union's policy, concluding that because National Union's language defined an occurrence as something that results in bodily injury or property damage "neither expected nor intended from the standpoint of the Insured," the National Union policy's definition of occurrence contained a subjective element absent in the *Kvaerner* case. 83 A.3d at 424–25.

Finally, the Superior Court refused to apply the gist-of-the-action doctrine to eliminate the tort-based claims from the underlying complaints against the insured and preclude coverage. Id. at 425–26. As an initial matter, the court observed that the gist-of-the-action doctrine has not been adopted by the Supreme Court of Pennsylvania in an insurance coverage context. Id. at 426. The court held that the gist-of-the-action doctrine is not relevant to an analysis of whether the in-

surer has a duty to defend. Thus, the Superior Court determined that because the underlying complaints alleged personal injuries and damage to property other than the work itself that were neither intended nor expected by the insured, National Union was not entitled to summary judgment.

At the time of publication, National Union's petition for allowance of appeal of the *Indalex* case remains pending before Pennsylvania's Supreme Court. As such, it cannot be predicted with any certainty whether the *Indalex* decision will remain binding precedent. Nevertheless, the case does represent a departure from the Superior Court's prior application and analysis of the *Kvaerner* precedent and may signify a softening of that court's rigid stance on insurance coverage for claims of defective construction arising from faulty workmanship. On the other hand, because the *Indalex* decision couches its holding in terms of defects in "off-the-shelf" products, even if upheld, the case's lasting holding may be of limited help to contractors.

In light of the above, a great deal of uncertainty remains regarding the coverage available for claims arising from faulty workmanship. Thus, general contractors should closely review their policies and attempt to negotiate additional endorsements with their carriers that will restore the level of coverage they had pre-*Kvaerner* and its progeny. Because contractors often can pay to obtain endorsements to buy back that which *Kvaerner* and its progeny took away, a review of the applicable insurance information by an owner at the contracting stage is vital for their ability to recover for such a loss, especially if the defaulting contractor is financially unable to cover the damages. It is also vital to the protection of the defaulting contractor since that contractor could still be liable in contract but not have insurance coverage to back up the loss.

7-6 CONCLUSION

Construction defects claims are some of the most interesting and problematic issues to arise on a construction project given the often varying and unique damages that they cause. Those differing types of damages can affect different groups, and can give rise to various types of contract and tort-based claims. What causes of action an affected party can avail itself of, or be liable for, will depend on whether that party is performing under a contract for the defective work or materials, what types of damages are incurred, and whether insurance coverage can be secured for the losses suffered.