

Querrey & Harrow

Construction Law Quarterly

Issue No. Thirty-seven

Summer, 2007

OSHA Changes the Game for General Contractors

Jillian Book

Querrey & Harrow - Wheaton, Illinois

On April 27, 2007, the Occupational Safety and Health Review Commission (OSHRC) handed down a decision in *Secretary of Labor v. Summit Contractors, Inc.*, OSHRC No. 03-1622, which strikes down the Occupational Safety and Health Administration's (OSHA) authority to issue citations to general contractors based on violations committed by subcontractors in construction work settings. Although the decision is currently pending an appeal in the U.S. Court of Appeals for the 8th Circuit, it marks a resolution to years of conflict and "marked tension" between the enforcement policy and an OSHA regulation 29 C.F.R. §1910.12(a).

In 1971, OSHA adopted 29 C.F.R. §1910.12(a), which states that "[e]ach employer shall protect the employment and places of employment of each of his employees engaged in construction work by complying with... appropriate standards..." Thereafter, a standard policy was enacted to govern issuing citations in connection with §1910.12(a). Since 1971, various changes have been made to the enforcement policy. The most significant change came in 1994 when OSHA issued its Firm Inspection Reference Manual (FIRM) which stated that violation citations should be issued to not only exposing employers, but also employers that create, control or may be able to correct the hazard. Commonly known as the Multi-Employer Citation Policy, it applies even if an employer does not have any of its own employees exposed to the safety hazard.

The decision in *Secretary of Labor v. Summit Contractors, Inc.* challenged the authority of OSHA to issue a citation to a general contractor based on a subcontractor's scaffolding violations. In a split decision, OSHRC Chairman, W. Scott Railton, found that the reliance on the Multi-Employer Citation Policy was "impermissible given the contrary language of ... §1910.12(a)." He opined that the language of §1910.12(a) clearly states "his employees" and has no grounds to support a citation issuance to an employer without employees exposed to the danger.

In clarifying his opinion, Railton explained that there has been a "marked tension" between §1910.12(a) and the Multi-Employer Citation Policy (Policy) since its inception in 1994. Although the issue had gone undecided, it could no longer be overlooked. Railton explained that the ever-changing policy guidelines since 1971, with no amendment to §1910.12(a) since that time, clearly show that "[t]he Commission must give effect to the plain language of the regulation, especially in the face of the Secretary's inconsistent doctrine."

Special Note: This decision to invalidate the Policy is strictly confined to construction work defined in §1910.12(b) as "work for construction, alteration, and/or repair, including painting and decorating." The Policy remains applicable to those in "general industry" under 29 C.F.R. §1910.

Liability on a jobsite plays a critical role when it comes to lawsuits arising out of construction accidents. The focus of contention for contractors is the standard duty of care that they are required to follow. Prior to the OSHRC's decision, this meant that general contractors could easily be cited and have the citation used against them on the question of liability in a large lawsuit, even if none of its employees were involved. If the OSHRC decision is affirmed, contractors can be assured that a citation will only be valid in a construction work setting if the violation pertains to its own employees exposed to danger.

Insurer Must Defend Suit For Negligent Construction

Jennifer L. Medenwald

Querrey & Harrow - Chicago

In *Viking Construction Management, Inc. v. Liberty Mutual Insurance Co.*, 358 Ill.App.3d 39, 831 N.E.2d 1 (1st Dist. 2005), the court held that a contractor's commercial liability insurance policy did not cover breach of contract claims for defective workmanship and that there had been no occurrence as required by the policy. However, another Illinois Appellate Court recently determined that alleged negligent construction work constituted an "occurrence" as that term was defined in a commercial general liability policy such that insurance coverage was owed to a general contractor. *Country Mutual Ins. Co. v. Carr*, 372 Ill.App.3d 335 (4th Dist. 2007).

continued on page 2

In *Country Mutual*, Steve Carr (“Carr”), d/b/a Carr Construction, purchased a commercial general liability insurance policy from Country Mutual Insurance Company (“Country Mutual”). The commercial general liability policy provided, in relevant part:

This insurance applies to “bodily injury” and “property damage” only if:

- (1) The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory”; and
- (2) The “bodily injury” or “property damage” occurs during the policy period.

* * *

“Property damage” means:

- a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
- b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the “occurrence” that caused it.

* * *

“Occurrence” means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

After Carr purchased the commercial general liability policy, he was sued for alleged damage to a home he had constructed. Specifically, the underlying complaint charged Carr with having negligently placed inappropriate backfill and grade around the basement of the constructed home and negligently operated heavy earthmoving equipment close to the basement walls, causing sudden movement and damage to the basement walls.

Alternatively, the underlying complaint alleged that Carr negligently contracted with a subcontractor who was responsible for the damage to the basement walls. The underlying complaint also alleged that Carr breached an implied warranty of habitability for his work at or around the basement walls and for failing to construct other portions of the subject residence in a workmanlike manner.

Carr requested that Country Mutual defend and indemnify him in the underlying suit. Country Mutual refused to do so and ultimately filed a separate action seeking a declaration that it had no duty to defend or indemnify Carr in the underlying suit because that action alleged no “occurrence” as defined by the Country Mutual policy. Country Mutual successfully moved for judgment on the pleadings in the declaratory judgment action. Carr later appealed that ruling.

On appeal, the appellate court reversed the trial court’s ruling in Country Mutual’s favor, determining that Country Mutual owed a duty to defend Carr in the underlying suit. In doing so, the appellate court noted that whether an insurer has a duty to defend is generally determined by comparing the allegations of the underlying complaint with the insurance policy provisions at issue. The appellate court further noted that a duty to defend is generally said to exist where a suit alleges a cause of action within, or potentially within, the coverage of an insured’s policy. The court emphasized that the allegations of an underlying action must be read liberally in a light most favorable to the insured.

Significantly, the appellate court observed that Country Mutual’s policy did not define the term “accident.” For that reason, the appellate court declared the policy to be ambiguous. Consequently, the appellate court noted that, for the purposes of determining whether the damage to the home Carr had constructed was the result of an “accident” and/or constituted an “occurrence,” Country Mutual’s commercial general liability policy had to be read liberally in favor of coverage.

According to the appellate court, the question to be analyzed was whether Carr intended or expected the damage to the basement walls and the other parts of the subject constructed residence. Notably, the underlying complaint was devoid of any allegations that Carr or his employees, agents or subcontractors intended or expected by their use of alleged inappropriate backfill material or their purported negligent operation of heavy earthmoving equipment near the basement walls that the walls would move or be damaged. As such, the appellate court determined that the allegations of the underlying complaint described an “occurrence” as defined by the Country Mutual policy and that a duty to defend was owed.

Many legal commentators thought that *Viking Construction Management* put to rest any possibility that a claim for defective construction was covered by standard commercial liability insurance policies. However, *Country Mutual* has reopened the door to that possibility.

Wrongful Death Act Amended

Jillian Book

Querrey & Harrow - Wheaton, IL

On May 31, 2007, Governor Rod Blagojevich signed into law House Bill 1798 which amends the language of 740 ILCS 180/2, the Wrongful Death Act. Although only a few words were added, the implications are far reaching. The Act, as amended, now specifies that a surviving spouse and next of kin can recover pecuniary damages, “including damages for grief, sorrow, and mental suffering.” This amendment now opens the door for the possibility of astronomical awards based on personal and intangible familial emotions.

Since the mid-1800’s in Illinois, damages in wrongful death cases focused on the decedent’s economic characteristics. In 1867, the Illinois Supreme Court held that money damages were not appropriate recovery for grief, stating that

there is “no recovery for bereavement.” *Chicago & A.R. Co. v. Shannon*, 43 Ill. 338, 346 (1867). This led to the development of an appropriate jury instruction to reflect the court’s holding. Illinois Pattern Jury Instruction (Civil) 37.01 – Measure of Damages – Wrongful Death – Factors Excluded, states that the jury “may not consider ... [t]he grief or sorrow of the widow and next of kin...” in determining pecuniary losses. This meant that motions in limine were critical to bar the expression of grief, because the surviving spouse or next of kin was limited to recovery for the loss of the decedent’s economic support and loss of society.

Proponents of the amendment argued that this limitation prevented appropriate recovery because, many times, the only substantial impact felt was in the form of grief and suffering by the surviving spouse or next of kin. It was argued that this amendment would finally give a true assessment to the “damage” caused by a wrongful death. More than twenty other states already allow for recovery of damages based on grief and sorrow, with some even extending recovery to that which is reasonably probable to be experienced in the future.

Those opposed to the amendment argued that following the lead of these other jurisdictions is not the right answer. Many fear that the cost of doing business and the cost of insurance will skyrocket as a result of the change. The amendment means that juries now have additional factors to consider in determining recovery. Typically, the circumstances of a wrongful death in a construction case are traumatic. Because grief and sorrow are intangibles by nature, there is a real possibility of juries inflating awards by way of a “catch-all” category for damages.

Because the amendment was just recently signed into law, the true impact is yet to be seen. The amendment applies to all actions accruing on or after May 31, 2007, although an appropriate new jury instruction has not yet been introduced. It is clear that there will be no shortage of heart-wrenching testimony from all those affected by the death. The true key will undoubtedly be how the courts decipher appropriate grief and sorrow testimony, and testimony that is more prejudicial than probative. It is safe to assume that a sympathetic jury will be a challenge to control from a defense perspective, especially when an argument must be made against the emotions experienced from the loss of a loved one.

Insurer Can Recover Under Unjust Enrichment When Trial Court Incorrectly Finds A Duty To Defend

Anthony J. Madormo
Querrey & Harrow - Chicago

A recent Illinois Appellate Court decision held that where an insured received payment of its defense costs as a result of an erroneous trial court ruling that the insurer owed a duty to defend, an unjust enrichment claim can be alleged to require the insured to repay the insurer the amount it paid for defense costs. *Steadfast Insurance Company v. Caremark Rx, Inc.*, 2007 Ill.App. LEXIS, May 22, 2007, (1st Dist.). Caremark, the insured, was sued for

breach of fiduciary duties under various federal statutes. Caremark tendered its defense in the underlying lawsuits to Steadfast, the insurer. Steadfast denied it had a duty to defend or indemnify Caremark.

Steadfast filed a complaint for declaratory judgment seeking a declaration that it had no duty to defend or indemnify Caremark in the underlying cases. The trial court ruled that Steadfast had a duty to defend and Steadfast appealed the decision. While the trial court decision was on appeal, Steadfast reimbursed Caremark for the defense costs it had incurred in the underlying action. The appellate court reversed the trial court’s order and held that Steadfast owed no duty to Caremark to defend it in the underlying action (Steadfast I).

The case was remanded and Steadfast filed a motion for restitution, seeking to recover the defense costs it had paid. The trial court denied Steadfast’s motion for restitution, holding that Steadfast’s filing a declaratory judgment action was the “functional equivalent” of an agreement to defend Caremark under a reservation of rights, thus owing defense costs until they won the appeal. Steadfast maintained that it paid the defense costs solely to comply with the trial court’s order that it owed Caremark a defense and was entitled to the repayment of the defense costs it was incorrectly required to pay.

Steadfast appealed the trial court’s order (Steadfast II). The appellate court reasoned that the Steadfast I court found, as a matter of law, that the factual allegations in the underlying federal cases did not assert conduct that triggered Steadfast’s policy. Therefore, Steadfast’s duty to defend Caremark, while the appeal was pending, did not arise out of a contractual obligation, but arose out of the trial court’s erroneous order. Notwithstanding various procedural issues in the underlying case, the appellate court ultimately concluded that Steadfast should be allowed to amend its complaint to seek recovery for unjust enrichment against Caremark to recover the defense costs it paid.

This case discusses the holding of *General Agents Insurance Company of America, Inc. v. Midwest Sporting Goods Company*, 215 Ill. 2d 146, 828 N.E.2d 1092 (2005). There, the court held that if a policy contains a provision allowing for the recovery of defense costs paid while defending under a reservation of rights, the provision may be enforceable. The insurer, however, must state its position on the costs of defense in a reservation of rights letter. Then, if the court holds the insurer does not owe a duty to defend, the insured must reimburse the insurer for the defense costs incurred by the insurer.

The holding in *Steadfast* does not expand or directly impact the *General Agents* holding. The *Steadfast* holding appears to be fact-specific. Where an insurance policy does not have any language regarding reimbursement of defense costs paid under a reservation of rights but an insurer prevails in a declaratory action, if the trial court improperly found a duty to defend and that decision is overturned, then the insurer can plead an unjust enrichment theory to recover defense costs it paid, because of the erroneous trial court ruling.

Court Bars Negligence Claims Against Architects And Engineers

Scott Krider

Querrey & Harrow - Chicago

Illinois courts have generally held that tort theory is appropriately suited for personal injury or property damage resulting from a sudden or dangerous occurrence, while the remedy for economic loss, meaning a loss relating to a purchaser's disappointed expectations, should be resolved by contract law. This doctrine, known as the *Moorman* Doctrine, has been the law in Illinois since 1982. The Illinois Appellate Court recently affirmed the *Moorman* Doctrine in the case of *F.H. Paschen/S.N. Nielsen v. Burnham Station, LLC*, 372 Ill. App. 3d 89, 865 N.E. 2d. 228 (2007).

In this case, the plaintiff was an investor in a limited liability company, set up to acquire and develop real estate for the construction of condominiums and town homes. The LLC was managed by one of the members, a separate entity, JDL Development. This company entered into a contract with an architect to draw up the architectural drawings. As the court said, "The project did not go as was planned" and the plaintiff lost a significant amount of its investment. The plaintiff sued the architect on theory of derivative breach of contract and professional negligence for inadequate plans.

The court first addressed the issue of the contract claim. There was no direct contract between the investor and the architect, thereby defeating the claim.

The court also rejected the argument that the investor was a third party beneficiary of the agreement between the managing member and the investor plaintiff. It is not enough that the investor gained some incidental benefit from the architect's agreement. The test is whether the benefit to the investor was a direct or incidental benefit arising out of the agreement with a third party. Generally, a court requires an express provision of third party beneficiary status because contracts presumably only apply to the parties to the agreement.

The court then addressed the *Moorman* Doctrine, reaffirming that the investor could not seek recovery under a professional negligence theory against the architect. The *Moorman* Doctrine has an exception for parties who negligently misrepresent conditions who are in the business of supplying information. However, Illinois courts have consistently ruled that architects are not in the business of supplying information. In short, to bring a claim directly against an architect, one typically needs a direct agreement with architect and the claim would typically be for breach of contract, not negligence. Negligence actions are generally allowed when the underlying incident raises issues of safety, rather than disappointed contract expectations. This case highlights that the *Moorman* Doctrine is alive and well in Illinois.

Using Substitute Materials Can Lead To Litigation If Not Of The Same Quality

Nicholas Johnson

Querrey & Harrow, Ltd. - Waukegan

In the recent case of *Elovic v. Nagar Construction Company, Inc.*, 2007 U.S. Dist. LEXIS 28538 (N.D.Ill. April 16, 2007), the United States District Court for the Northern District of Illinois addressed the issue of whether a cause of action exists under the Illinois Consumer Fraud and Deceptive Business Practices Act (CFA), common law contract principles, the Magnuson-Moss Warranty – Federal Trade Commission Improvement Act, a theory of negligence, and warranty of habitability when Hurd windows were used on a project instead of Pella windows. The Elovics contracted with Nagar to construct a residence. The agreement incorporated the architect's blueprints which specified Pella brand windows. Nagar subcontracted with Estates to do the window installation on the project. Estates installed Hurd windows instead of Pella windows as required by the agreement.

After completion of the project, the Elovics moved in and experienced problems with the Hurd windows. Specifically, an excessive amount of moisture was accumulating near all the windows, causing fogging and icing. The Elovics told Nagar of the problems and were told by Nagar that moisture in the building project was typical. Estates also told them that the issue would resolve itself within a year.

The next year the Elovics experienced the same problem. This time the Elovics were told that the problem was due to excess humidity and that the Elovics must stop using their humidifier. At that point, the Elovics monitored the humidity levels in their residence, but still experienced problems the following winter. When the Elovics notified Nagar and Estates, the Elovics were told to purchase and install a dehumidifier, which they did. Finally, the Elovics discovered that the true cause of their problem was inferior windows. The Elovics learned that Hurd windows had a "U-factor" energy performance rating that was insufficient for their geographic area.

The defendants first claimed that the statute of limitations barred the Elovics' claims because it was more than four years since the windows were installed. The court rejected this argument finding that the Elovics did not discover the problems with the windows until they finally discovered that the windows themselves were the source of the condensation and not another cause.

Next, the defendants claimed that the Elovics did not properly state a claim under the CFA or under a breach of implied warranty of habitability claim. The court responded that the Elovics have properly alleged that the low U-factor was not appropriate for the area where the Elovics' residence was located, which was enough to state a cause of action.

Finally, the defendants claimed that the *Moorman* doctrine barred recovery. The court again rejected this notion since the Elovics sought non-economic losses related to the replacement costs of the windows, the persistence of mold which required removal, and the physical injury to the persons that inhabited their residence.

Contractor And Owner Held Liable For Copyright Infringement

Devon Eggert

Querrey & Harrow - Chicago

When can an owner or contractor reproduce an architect's drawings without his or her express permission? The Central District of Illinois recently found both a contractor and an owner liable in such a scenario.

In *Francois v. Ruch, et al.*, 2006 U.S. Dist. LEXIS 57062, 81 U.S.P.Q.2d (BNA) 1485 (C.D. Ill. Aug. 14, 2006), an architect sued both an owner and contractor for copyright infringement. In August, 2000, Russell Francois ("Francois") met with representatives of Dr. Monica Schnack's chiropractic office ("Schnack") to discuss the construction of a new building for the Schnack practice. Francois was eventually hired to prepare drawings for the building. No written agreement was ever executed.

In September, 2001, Francois submitted to Schnack a "substantially final" set of construction documents. Francois also issued the construction documents to several contractors for the purpose of soliciting bids. Co-defendant, Jack Ruch Quality Homes ("Ruch Homes") was one of these contractors. Each page of this document stated that Francois was the owner of the documents, and the architect would "retain all common law, statutory and other reserved rights in addition to copyright."

The bid opening for the project took place on October 23, 2002. The lowest bid entered was \$566,900. Schnack left the meeting disappointed about how high the bids ran. Within a week, Schnack fired Francois as the architect on the project. Schnack then met with Ruch Homes and stated she had purchased the construction documents from Francois; in fact, Schnack had not purchased the drawings. Ruch Homes then redesigned the building in a fashion substantially similar to Francois' submittal. Francois sued Ruch Homes and Schnack for copyright infringement and breach of contract.

Schnack filed a motion for summary judgment on all counts of the complaint. Regarding the copyright infringement claim, Schnack claimed the verbal contract between the parties contained an implied license for Schnack to use the drawings with or without Francois' involvement in the project. The court denied Schnack's motion for summary judgment. In the absence of any written agreement, the court mainly relied on the party's conduct. The court considered Francois' continued involvement in the selection of contractors and bidding process as strong evidence against an implied license. The court also noted that Schnack did not dispute that the agreement called for Francois to work through the completion of the project. "Such statements could cast doubt on the defendant's position that Francois gave...a license to use his plans with or without his involvement." Based on these facts, the court found issues of fact regarding an implied non-exclusive license.

The case subsequently went to trial, and a jury awarded Francois damages against Schnack for both breach of contract and copyright infringement and against Ruch Homes for copyright infringement. See *Francois v. Ruch*, 2006 U.S. Dist. LEXIS 90804 (C.D. Ill. Dec. 15, 2006). The defendants filed post-trial motions for judgment as a matter of law regarding the finding of copyright infringement. Schnack argued the evidence did not support a finding that it had vicariously infringed Francois' copyright on the construction documents. The court denied Schnack's motion and found the evidence regarding the relationship between Schnack and Ruch Homes sufficient for the jury to find the requisite knowledge, control and financial interest by Schnack. The court found Ruch Homes motion to be identical to that of Schnack and denied its motion for identical reasons.

Francois shows the precautions both contractors and owners should take when dealing with architects. While Ruch Homes actually copied the drawings, Schnack certainly facilitated the infringement. Likewise, Ruch Homes was found liable for infringement notwithstanding Schnack's false assertions that it was authorized to use Francois' drawings. If a contractor or owner is planning on reproducing an architect's drawings or construction documents, those parties should include express written provisions to avoid copyright infringement.

Querrey & Harrow Staff Assists Misericordia

Once a year, Querrey & Harrow attorneys and staff volunteer to hit the streets of Chicago to raise money for Misericordia, a charity operated by the Sisters of Mercy under the auspices of the Catholic Bishop of Chicago to provide support for persons with developmental disabilities. At present, Misericordia supports 550 children and adults from all racial, religious and socio-economic backgrounds. It offers a wide range of services, including residential placement and day-to-day support, job training and employment opportunities, physical, occupational and speech therapy, fitness and healthy living guidance, social and recreational outings and opportunities for spiritual growth.

Last year, in one day Querrey & Harrow raised \$7,997.82 for Misericordia. On April 27, 2007, Querrey & Harrow raised \$13,328.62. Eileen Madda, Julie Heinzl and Laurie Shannon coordinated the Querrey & Harrow volunteer effort.

Construction Notes

In a recent ruling, Judge Nancy J. Arnold of the Circuit Court of Cook County, Illinois awarded ten subcontractors \$6.88 million in a judgment, including \$1,000,000 in punitive damages, against a lender which had convinced each of them to return to finish a construction project with no intent of paying them in full. *Professional Plumbing, Inc. v. Residential Funding Company*, Cause No. 01 CH 3033.

Most construction contracts provide that one or more of the parties be listed as additional insureds under a contractor's insurance policies. However, many insurers state that their policies will only cover additional insureds if the contract between the parties requires such an endorsement in writing. In a recent case, the Illinois Appellate Court held that a verbal agreement to provide additional insurance coverage was not sufficient. *Cincinnati Insurance Co. v. Gateway Construction, Inc.*, 2007 Ill.App.3d 148 (1st Dist. 2007).

In a recent contract matter, the U.S. Department of Transportation rejected a bid because the bidder had failed to acknowledge the department's amendment to its invitation for bids changing the exterior color of a restroom facility. The unsuccessful bidder challenged the rejection of the bid. The U.S. Comptroller General affirmed the decision of the department noting that the failure to acknowledge the amendment made the bid non-responsive. *In re Northern Sealcoating & Paving, Inc.*, 2007 U.S. Comp. Gen. LEXIS 53, 2007 Comp. Gen. Proc. Dec. P67 (2007).

The U.S. Department of the Navy now is permitted to enter into binding arbitration procedures for its procurement contracts. See 72 Fed. Reg. 13094, March 20, 2007.

In an arbitration matter, the Illinois Appellate Court held that arbitrators in a business dispute could not enter an award reforming a contract. *First Merit Realty Services, Inc. v. Amberly Square Apartments*, 1st Dist., March 20, 2007.

Copyright (c) 2007 Querrey & Harrow, Ltd.
All rights reserved.

Bruce H. Schoumacher
Editor

Querrey & Harrow

www.querrey.com
800.678.2756

Illinois
Chicago, Illinois
312.540.7000

Crystal Lake, Illinois
815.479.1929

Joliet, Illinois
815.726.1600

Waukegan, Illinois
847.249.4440

Wheaton, Illinois
630.653.2600

Indiana
Merrillville, Indiana
219.738.1820