IN THE SUPREME COURT OF OHIO

MOTORISTS MUTUAL INSURANCE COMPANY,	:	CASE NO. 2020-0306
Plaintiff/Appellant,	:	On Appeal from the Wood County Court of Appeals, Sixth Appellate District, Case No. 2019 WD 0018
v.	:	
IRONICS, INC. and OWENS-BROCKWAY GLASS CONTAINER, INC.,	:	
Defendants/Appellees.	:	

MERITS BRIEF OF AMICUS CURIAE THE OHIO INSURANCE INSTITUTE IN SUPPORT OF APPELLANT MOTORISTS MUTUAL INSURANCE COMPANY

Natalia Steele (0082530)
Vorys, Sater, Seymour and Pease LLP
200 Public Square, Suite 1400
Cleveland, Ohio 44114
Tel: (216) 479-6187
Fax: (216) 937-3755
nsteele@vorys.com

Counsel for Amicus Curiae The Ohio Insurance Institute

Merle D. Evans, III (0019230)
Milligan Pusateri Co., LPA
P.O. Box 35459
4684 Douglas Circle N.W.
Canton, Ohio 44735
mevans@milliganpusateri.com

Counsel for Plaintiff/Appellant Motorists Mutual Insurance Company

Theodore M. Dunn, Jr (0024195)
Buckley King, LPA
1400 Fifth Third Center
600 Superior Avenue, East
Cleveland, Ohio 44114-2652
dunn@buckleyking.com

Counsel for Defendant/Appellee Ironics, Inc.

John Siciliano, Esq. (0019768)
John K. Nelson, Esq. (0013055)
Shumaker, Loop & Kendrick, LLP
1000 Jackson Street
Toledo, Ohio 43604-5573
jsiciliano@slk-law.com
jnelson@slk-law.com

Counsel for Defendant/Appellee Owens-Brockway Glass Container, Inc.

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THIS CASE RAISES ISSUES OF GREAT PUBLIC AND SPECIFIC INTEREST FOR *AMICUS CURIAE*

This case is a **simple breach of contract action**. Appellee Ironics, Inc.'s ("**Ironics**") **only obligation under the contract was to deliver usable tube scale for incorporation into** its customer's Owens-Brockway Glass Containers Inc. ("**Owens**") **glass bottles**. **Ironics failed** in its contractual duty and delivered non-conforming tube scale with this outcome:

- Product component delivered—tube scale—was non-conforming
- **The final product—bottles made with the non-conforming tube scale—did not break and did not damage or injure any other property or person**
- Ironics' customer that received the non-conforming tube scale—**Owens—decided it was too risky to use the final product and destroyed it**; Owens alleged **no damages beyond the loss of the bottles incorporating the non-conforming tube scale**

In its very clear opinion, the trial court below recognized that Owens' damage was pure economic loss that was not covered by Ironics' CGL or umbrella policies or, alternatively, was precluded from coverage by the policies' business risk exclusions.

Whether a delivery of a non-conforming product is an "occurrence" is fundamental to both the CGL and the umbrella policy coverage determination. The Court of **Appeals**, however, first **abandoned the analysis of relevant law and just assumed that defective workmanship rises to the level of "occurrence"** necessary to trigger coverage—**an accident**—simply because a manufacturer like Ironics certainly does not intend to supply defective components to its customers in the ordinary business course. The Court of Appeals **then acknowledged (in reviewing the CGL policy) and quickly abandoned (in reviewing the umbrella policy) the economic loss rule**, upending settled law **to convert a simple breach of contract action into a tort**.

The practical result of the Court of Appeals' unwarranted assumptions and contorted reading of the policy and exclusions language is that **the delivery of a non-conforming product**

under a contract that injures no other property or person—like Ironics' delivery of contaminated tube scale that ruined only the product that incorporated the scale—**is a type of unpredictable, accidental, traumatic, and purely fortuitous "occurrence" capable of triggering liability coverage.**

By further reading "accidental" entirely out of the umbrella policy definition of "occurrence," **the Court of Appeals converted Ironics' liability insurance into, essentially, a performance bond**. The Court of Appeals went even further **and read the umbrella policy's express business risk exclusions so narrowly as to make them meaningless**.

If left to stand, the Court of Appeals' decision here will create confusion and **will severely restrict availability and affordability of umbrella insurance policies, drastically reducing protections for Ohio businesses and ordinary citizens alike**. Clarity on the type of conduct that triggers standard CGL and umbrella liability coverage is of great public interest and particular interest to *amicus curiae* The Ohio Insurance Institute ("OII").

This unwarranted and **unprecedented expansion of the limits of liability and umbrella insurance coverage** will have the effect of converting every unintentional breach of contract into "accidental" conduct and nearly every breach of contract case into a tort and products liability case. This result **is contrary to the established law both in Ohio and in other states, and will undoubtedly make insurance coverage less affordable and less available for all Ohio citizens—businesses and individuals alike**.

STATEMENT OF INTEREST OF *AMICUS CURIAE*

OII is uniquely qualified to provide this Court with a broad perspective on the principles of insurance law relevant to this appeal, as well as practical insight into the negative consequences for insurers and insureds alike if the ruling below is upheld. OII is the professional

trade association for property and casualty insurance companies in the State of Ohio, and its members include twenty-seven domestic property and casualty insurers, twelve foreign property and casualty insurers and reinsurers, seven insurance trade associations, and four insurance-related organizations. OII's member companies represent 87% of Ohio's private passenger auto insurance market, 81% of the homeowners market and 50% of the commercial market (based on 2017 market share data from the Ohio Department of Insurance).

OII provides a wide range of services to its members and to the public, media, and government officials in three primary areas: education and research, legislative and regulatory affairs, and public information. In connection with these activities, OII closely monitors judicial decisions in Ohio that address important issues of insurance law, and it has participated as an *amicus* in several landmark insurance cases decided by this Court.

The **legal questions** presented **in this case directly concern OII and its members because the outcome could result in significant reduction in affordability and availability of liability and umbrella insurance policies**. Inability to secure or afford insurance coverage **can cause bankruptcies in productive enterprises**, with consequent **disappearance of jobs**, and **leave certain segments of society unprotected, or insufficiently protected, against truly traumatic injuries**.

ARGUMENT IN SUPPORT OF PROPOSITIONS OF LAW

I. PROPOSITION OF LAW NO. I: THE INCORPORATION OF A DEFECTIVE INGREDIENT INTO AN INTEGRATED PRODUCT OR SYSTEM DOES NOT CONSTITUTE DAMAGE TO "OTHER" PROPERTY FOR PURPOSES OF LIABILITY COVERAGE UNDER COMMERCIAL GENERAL LIABILITY AND UMBRELLA POLICIES

A. Whether A Manufacturing Defect Is An "Occurrence" Is Fundamental To The Determination Of The Starting Point Of Liability Coverage, Yet Court Of Appeals Abandoned This Critical Analysis

CGL and umbrella policies were never intended to serve as performance bonds or to insure ordinary business risks. These policies were designed to insure against damage that goes beyond product defects that affect only the final product itself**—they insure against consequential damage by the insured to *other* persons or *other* property.** *Ohio N. Univ. v. Charles Constr. Servs.*, 155 Ohio St.3d 197; 2018-Ohio-4057; 120 N.E.3d 762, ¶14 ("[liability] policies do not insure an insured's work itself; rather, the policies generally insure consequential risks that stem from the insured's work"), *citing Westfield Ins. Co. v. Custom Agri Systems, Inc.*, 133 Ohio St.3d 476, 2012-Ohio-4712, 979 N.E.2d 269, ¶10. **Whether faulty work can be considered other "property damage" caused by an "occurrence" is the fundamental question under any liability policy**. *See Ohio N. Univ.* at ¶15.

The Court of Appeals upended the well-established law by:

(1) skipping the first critical step of its coverage analysis **and redefining "occurrence" to mean any unintentional** (thus "accidental") **delivery of a defective or non-conforming product,** and

(2) both <u>adopting AND rejecting</u> the economic loss rule and the integrated product concept, reaching diametrically opposed legal conclusions with respect to two types of liability policies that serve the same purpose—CGL and umbrella.

The Court of Appeals' **wildly different treatment of the two policies that are rooted in the same definitions of "occurrence" and "property damage" defies existing Ohio law, the**

Court of Appeals' own initial analysis, and critically, the expectations of OII's members concerning the types of conduct covered by liability insurance policies.

B. Commercial General Liability Policies And Umbrella Policies Are Not Performance Bonds; They Do Not Insure Ordinary Business Risks That Are Matters Of Warranty And UCC-Based Claims

Commercial liability policies are not intended "to insure business risks that are normal, frequent, or predictable consequences of doing business and **which businesses can control or manage**." *Ohio N. Univ.* at ¶14. Such policies **provide coverage for "tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained**." *Westfied Ins. Co. v. Riehle,* 113 Oho App.3d 249, 680 N.E.2d 1025 (6th Dist. 1996). *See also Custom Agri Sys., Inc.*, 2012 Ohio 4712 at ¶10 (citation omitted) (**liability policies** "are intended to insure the risk of an insured causing damage to other persons and their property, but . . . **are not intended to insure the risk of an insured causing damage to the insured's own work**.") "**The risk intended to be insured [under a commercial liability policy] is the possibility** that the goods, **products or work of the insured,** once relinquished or completed, **will cause bodily injury or damage to property other than to the product or completed work itself,** and for which the insured may be found liable." *Drake-Williams Steel, Inc. v. Continental Cas. Co.*, 294 Neb. 386, 396, 883 N.W.2d 60 (2016). "**Physical injury requirements in [CGL and umbrella] insurance policies exist to prevent recovery of mere economic loss** . . . . Policies with such language are not intended to pay the costs of repair or replacing the insured's defective work and products." *U.S. Fire Ins. v. Peerless Ins. Co.*, 18 Mass.L.Rep. 64 (2004) (collecting cases).

Ironics' only obligation was to deliver tube scale; delivering defective tube scale was not an "accident," but only a breach of contract

Ironics breached its contractual obligation to Owens by delivering contaminated tube scale, and Owens had to destroy the entire lot of glass product it made with the contaminated tube scale. **Ironics had total control over the quality of its product—the task that all business are expected to manage to deliver conforming products—failed in that task and deprived Owens of the benefit of its bargain with Ironics**. The only loss Owens suffered was economic—the loss of its glass product incorporating Ironics' contaminated tube scale. **The finished glass product injured no one and damaged no other property. Owens suggested no type of loss other than the economic loss of unusable glass.**

Delivery of the non-conforming product that fails customer's contracted-for expectations is not an "accident" that results in separate property damage or personal injury. *See Custom Agri*. at ¶10. "**A commercial general liability policy is not intended to provide coverage for the insured's contractual liability which merely causes economic losses**." *Park-Ohio Holdings Corp. v. Liberty Mut. Fire Ins. Co*., 142 F.Supp. 3d 556, 562 (N.D.Ohio 2015) (citing 9 Couch on Insurance § 129:4).

Owens' dispute with Ironics over the final product for which Ironics supplied the non-conforming ingredient is a dispute between two commercial entities that documented their agreement and expectations via purchase orders containing specific terms and conditions of their arrangement. **Ironics' failure to deliver a quality ingredient to Owens is a type of business risk that general liability or umbrella policies simply do not cover, because these risks, absent injury to persons or separate property, are matters addressed by the parties' contracts and the Uniform Commercial Code**. *Chemtrol Adhesives, Inc. v. American Mfgs.*

Mut. Ins. Co., 42 Ohio St.3d 40, 537 N.E.2d 624 (1989); *see also HDM Flugservice GmbH v. Parker Hannifin Corp.*, 332 F.3d 1025, 1029-1030 (6th Cir.2003) ("**among commercial parties, the U.C.C. provides a comprehensive scheme for parties to recover their economic losses**"). **A policy of comprehensive general liability insurance** does not create in the insured a commercially reasonable expectation that the policy will cover a loss caused by breach of contract, breach of warranty, poor workmanship or improper design. *See HDM Flugservice GmbH.*

The policy "[**is] not a guarantee or contractual performance bond**." *Aetna Cas. & Sur. Co. v. McIbs, Inc.*, 684 F.Supp. 246, 249 (D.Nev.1988) (insured who defectively manufactured molds used to produce concrete blocks was not entitled to recover damages paid to co-producer for loss of anticipated profits because such damages not within definition of property damage).

Insuring breaches of contract as a "tort" insulates poor workmanship

If a CGL or an umbrella policy can be reduced to nothing more than a performance bond, the insured manufacturers or contractors "**would not be discouraged from defective workmanship** since he or she would recover from the insurer even if the diminution in value to the [final] project arose solely due [to] the defectiveness of its own work." *New Hampshire Ins. Co. v. Vieira*, 930 F.2d 696, 701 (9th Cir.1991) (diminution in value of the property caused by a contractor's poor workmanship—failure to install drywall in a housing project—was not covered "property damage" under a CGL policy); *Natl. Union Fire Ins. Co. of Pittsburgh, PA v. Turner Constr. Co.*, 119 A.D.3d 103, 2014 NY Slip Op 3607, 986 N.Y.S.2d 74, ¶5 ("**adopting the definition of 'occurrence' [that would require the CGL/umbrella insurer] to cover the breach of contract and poor workmanship claims . . . would essentially transform [the**

policies] into a surety or performance bond. That is not the nature of [CGl and umbrella] coverage").

C. The Trial Court Properly Reasoned That Only Purely "Accidental" And "Fortuitous" Events Qualify As "Occurrences" That Trigger CGL Coverage; Court Of Appeals Created A Definition That Upends Ohio Law

In *Custom Agri.*, the Court explained that understanding the purpose of commercial liability policies is critical to any coverage analysis, and the court reviewing a liability policy to determine if coverage exists must still decide whether the alleged "defective . . . workmanship . . . constitute[s] property damage caused by an 'occurrence.'" *Custom Agri*. at ¶11. **Ohio law is clear that an "occurrence" is the fundamental threshold required to trigger liability coverage**, and, as it is in the underlying policies, the "occurrence" is defined as "an "accident." Faulty workmanship is a "business risk" and not an "accident"; faulty workmanship is predictable and not "fortuitous." *Charles Costr. Servs.*, 155 Ohio St.3d 197, 2018 Ohio 4057, 120 N.E.3d 762 at ¶16-18 (citations omitted); *Custom Agri Sys., Inc.*, 133 Ohio St.3d 476, 2012 Ohio 4712, 979 N.E.2d 269 at ¶13 (same). **Mere delivery of a non-conforming component under a commercial contract for incorporation into a final product is not an "occurrence" because it is not "accidental" in nature**. *Royal Plastics v. State Auto. Mut. Ins. Co.*, 99 Ohio App. 3d 221, 650 N.E.2d 180, 225-226 (8th Dist. 1994) (finding that the CGL policy did not apply to a claim based on delivery of a defective pump component that damaged other components of the completed pump).

Court cannot "assume" an occurrence without examining the facts

Nevertheless, without any analysis or an explanation, the Court of Appeals improperly "assumed" that an "occurrence" took place when Ironics delivered non-conforming component to Owens. (January 17, 2020 Decision and Judgment at 9). The Court

of Appeals never explained why it made such an assumption. It simply chose to "assume . . . that delivery of the tube scale [the material made defective by Ironics' faulty workmanship] constitutes an occurrence under the [CGL policy]." Thus, **the Court of Appeals created its own definition of "occurrence"** that wrongfully assumes either that faulty workmanship is always "accidental," or that no "accident" or fortuity is required at all to trigger liability coverage.

However, again, the law is clear that "**a claim for faulty workmanship, in and of itself, is not an occurrence . . . because a failure of workmanship does not involve the fortuity required to constitute an accident**." *Park-Ohio Holdings Corp.*, 142 F.Supp. 3d at 562.

The Court of Appeals' assumption of "occurrence," without any explanation or justification, makes no sense. **The factual background of what happened is fundamental to whether it even qualifies as an "occurrence."** It is the basis for determining whether there is any coverage at all. **To merely "assume" something is an "occurrence" is a fundamental error in the analysis**.

The Court of Appeals' refusal from the outset to follow this Court's clear direction on what constitutes an "occurrence" **set up the cascade of inexplicable findings that led to its announcement of unprecedented new law, including acceptance of the economic loss and integrated property rules with respect to CGL, but not with respect to umbrella policy coverage**.

D. The Trial Court Properly Applied Economic Loss Rule And Integrated Property Concepts To The CGL And The Umbrella Policies; The Court Of Appeals' Failure To Apply Them Consistently Created Confusing And Unsustainable New Law

Courts have at times struggled with **what constitutes harm to "other property"** as compared to harm to the product itself. However, the Sixth Circuit Court of Appeals, interpreting

Ohio law *HDM Flugservice GmbH*, simplified this task by pointing out that the **focus should be on the underlying transaction and the purposes of the economic loss rule**.

Integrated product rule applies universally, based on the type of product at issue, not the type of insurance policy under consideration

Nearly every product today has components or ingredients incorporated into the final whole, and when an integrated product fails to perform as intended or malfunctions, "the cause will almost always be a component." *HDM Flugservice GmbH*, 332 F.3d at 1031. "**If the purchaser [of the final product] were allowed to sue component manufacturers for the damage to the integrated product, the purchaser would be able to circumvent the economic loss rule by recovering in tort instead of being limited to contract remedies**." *Id.* "Preventing a commercial buyer from recovering the damage to the product from the component manufacturer in tort comports with the policy behind prohibiting a purchaser recovering in tort for the product itself." *Id.* The *HDM Flugservice* court rejected the argument that a purchaser of a helicopter could recover from the landing gear manufacturer for damage the helicopter sustained when the gear malfunctioned. The purchaser had argued that the helicopter was "other," or separate, property from the landing gear component and thus not covered by the economic loss rule.

Supplying a defective or non-conforming component that damages the product only, without more is not a covered loss

Other state courts have also been able to arrive at the same conclusion through careful analysis. As the Supreme Court of Wisconsin correctly noted,

> A product that non-dangerously fails to function due to a product defect has clearly caused harm only to itself. A product that fails to function and causes harm to surrounding property has clearly caused harm to other property. . . . **When the product or system is deemed to be an integrated whole, courts treat such damage as harm to the product itself. In short, damage by a**

> **defective component of an integrated system to either the system as a whole or other system components is not damage to other property.**

Wis. Pharmacal Co., LLC v. Neb. Cultures of Cal., Inc., 2016 WI 14, ¶27; 367 WIS. 2D 221, 240; 876 N.W.2D 72 (2016) (citing RESTATEMENT (THIRD) OF TORTS §21 CMT. E (1997)) (emphasis supplied). The *Wis. Pharmacal* court properly determined that a probiotic supplement that incorporated a defective ingredient was an "integrated product" and not "other property" covered by a liability insurance policy. Wisconsin Pharmacal **had to destroy an entire batch of supplement tablets** because one of its suppliers provided an incorrect species of bacteria and that ingredient, once incorporated into the final products with other components, **made the whole product not usable**. Just as Wisconsin Pharmacal could not extract the wrong bacteria from its supplement, neither could Owens remove Ironics' contaminated tube scale from its glass and thus chose to discard the completed product.

The Court of Appeals should have applied the *HDM Flugservice* and *Wis. Pharmacal* logic here with respect to Owens' integrated glass that incorporated Ironics' non-conforming component. **Both with respect to the CGL and umbrella coverage, neither the final glass product, nor other components Owens used to make the glass it eventually had to scrap, were "other property" damaged by the defective tube scale.**

> A product that fails to function and causes harm to surrounding property has clearly caused harm to other property. However, **when a component part of a machine or a system destroys the rest of the machine or system** . . . [**and] the product or system is deemed to be an integrated whole, courts treat such damage as harm to the product itself.** When so characterized, the damage is excluded from the coverage of this Restatement. **A contrary holding would require a finding of property damage in virtually every case in which a product harms itself and would prevent contractual rules from serving their legitimate function in governing commercial transactions**.

RESTAT. 3D OF TORTS: PRODUCTS LIABILITY, §21 CMT. E (emphasis added). *See also Land O'Lakes, Inc. v. Ratajczak*, E.D.Wis. No. 14-C-1388, 2016 U.S. Dist. LEXIS 186706, at *6

(Aug. 24, 2016) (applying the same reasoning to animal feed—once a defective ingredient is mixed into the final feed product, "it becomes the product and does no harm to other property. Therefore, there can be no 'property damage'" for the purposes of commercial liability coverage).

Yet, the Court of Appeals treated the same product—Owens' glass that incorporated Ironics' tube scale—as <u>both</u> integrated (under the main CGL policy[1]) and as "other property" (under the umbrella policy[2]) to achieve incongruent conclusions.

While umbrella policies may provide coverage in addition to CGL policies, the economic loss principles do not cease to apply from one type of policy to the next

Evaluating the CGL policy, the Court of Appeals correctly applied the economic loss rule to find that Owens' glass products incorporating Ironics' non-conforming tube scale was not "other property" covered under the policy. Inexplicably, however, it **then made a sharp turn and declined to apply the same concept to the umbrella policy that defined "property damage" exactly the same way as the CGL policy**.

Umbrella policies may provide additional or other type of coverage not merely replacing underlying GCL coverage

The Court of Appeals appears to base its diametrically opposite conclusions on the language in the umbrella policy that appears to allow coverage for claims that may not be covered by the CGL policy. However, **if an umbrella policy provides coverage when CGL**

[1] January 17, 2020 Decision and Order at 14 ("[I]t is clear that that glass products into which the nonconforming tube scale was incorporated were not 'other property' for purposes of the application of the economic-loss rule.")

[2] *Id*. at 22 and 24 ("Because Ironics' transfer of nonconforming tube scale gave rise to the unintended and unexpected 'property damage,' the transfer meets the definition of 'occurrence.'"; "the integrated system rule adopted herein does not apply to the umbrella policy.") The definitions of "property damage" are identical between the CGL and the umbrella policy (*Cf.* Stipulations000129 at Definition 17 and Stipulations000212 at Definition J).

does not, it does so only in very limited circumstances specified in the policy and **for "losses of a *different character* than the more typical losses covered by liability insurance**.**"** *Ridgway v. Gulf Life Ins. Co.*, 578 F.2d 1026, 1030 (5th Cir.1978) (emphasis added). Specifically,

> the umbrella policy has two functions: 1) to provide for a higher limit of liability for those losses typically covered by liability insurance—general liability and comprehensive auto liability for bodily injury and property damage; 2) **to provide for some coverage of those less common losses not typically covered by liability insurance—*e.g.*, malpractice liability, advertiser's liability, blanket contractual liability, world-wide operations liability**, etc.

Id. (emphasis added).

Here, both policies provide the *same type* of coverage—coverage for "bodily injury" and "property damage" under certain circumstances—and the umbrella policy does not provide blanket contractual liability coverage. Both policies thus provide coverage for tort liability for injury to persons and damage to "other" property, but not for the kind of contractual liability Owens would assert against Ironics. Nevertheless, **the Court of Appeals read the umbrella policy as providing a *different type of coverage* from CGL because the umbrella policy does not expressly state that damage to "other" property triggers coverage. (January 17, 2020 Decision and Judgment at ¶35). But neither does the CGL policy** specify that damage to "other" property is required; instead, with respect to the CGL policy, the Court of Appeals essentially read the term "other" into the CGL policy properly to apply the economic loss rule. (*Id.* at ¶21).

Both policies provide the same coverage here

Where, as here, there is no language in either the CGL policy nor the umbrella policy which would afford coverage for contractual-type claims that are at the heart of Owens' dispute with Ironics, **arising out of faulty workmanship or performance, the economic loss rule prevents any recovery under the CGL <u>and</u> the umbrella policy**. *See e.g.*

Owners Ins. Co. v. Joyce Essien M.D., N.D.Ga. No. 1:10-cv-02487-JOF, 2011 U.S. Dist. LEXIS 170618, at *8, 10-11 (July 7, 2011) (absent clear language in the CGL and the umbrella policy that contractual and warranty claims are covered, there is no coverage for claims arising out of faulty construction of a building).

The **United States Supreme Court agrees that when "the injury suffered" is "the failure of the product to function properly [due to a defective component it] is the essence of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain, [not tort]**." *E. River Steamship Corp. v. Transameric Delaval*, 476 U.S. 858, 867-68, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986) (finding that recovery in tort for damage caused to vessels by defective engines was precluded by the economic loss rule). *See also Drake-Williams Steel, Inc. v. Continental Cas. Co.*, 294 Neb. 386, 397, 883 N.W.2d 60 (2016) (finding that because defective rebar incorporated into pile caps that could be repaired before the remaining structure's installation, no "property damage" occurred and a **contractor's liability to make the repairs to the integrated product that includes its defective component is "not what CGL policies are designed to protect against**. The costs of reinforcing the inadequate pile caps was **a business risk and not the kind of fortuitous event for which a CGL policy is obtained**.")

It defies law and common sense that for the purposes of CGL coverage, (1) the same underlying Ironic/Owens transaction was a matter of basic contract and did not give rise to tort-based claims and (2) the same underlying defective product was integrated and thus did not qualify as "other property," but the exact opposite would be true when evaluating umbrella coverage. The nature of the underlying transaction and product does not change with change in its insurance coverage

The Court should find that with respect to the same product, the integrated products rule and the economic loss rule apply evenly to both types of policies, and that the trial court correctly determined that damage to Owens' integrated glass product was not covered by the CGL policy or by the umbrella policy.

E. The Concept Of Fortuity Cannot Be Read Out Of The Umbrella Policy Without Abandoning The Very Purpose Of That Coverage

Having refused properly to analyze whether an "occurrence" took place in connection with the CGL policy, **the Court of Appeals then read the critical term "accident" and the concept of fortuity entirely out of the definition of "occurrence" in the umbrella policy.**[3] This sleight of hand allowed the Court of Appeals to then create a **new law that *any* event that results in merely "unintended or unexpected"[4] property damage, including shoddy workmanship that is a matter of ordinary business risk, triggers** umbrella **liability coverage**.

Yet Ironics had only one task to perform under the contract—deliver usable tube scale. It did not. That is a simple breach of contract. It is not an "accident" to deliver bad tube scale so that it now becomes a tort. That is an ordinary business risk.

The Court of Appeals offered no analysis or authority in support of its leap of logic

The Court of Appeals' only justification for its actions appears to be the presence of the term "event" in the umbrella policy's definition of "occurrence", which the Court of Appeals viewed as indicative of "broader" occurrence concept. However, to reach this conclusion, **the court below also ignored** the final clause of the umbrella policy's "occurrence" definition—the

[3] The umbrella policy defined "occurrence" as "[a]n accident, or a happening or event … which results in 'bodily injury' or 'property damage' neither expected nor intended from the standpoint of the insured."

[4] January 17, 2020 Decision and Judgment at 17.

part that states any "accident," "happening," or "event" cannot be "expected" or "intended" by the insured—i.e., **the "fortuity" concept inherent in all liability policies**.

As one court explained, **"**[**a] definition of 'occurrence' that includes a 'happening' or 'event'** as well as an "accident" **was developed by the insurance industry 'to provide clearly for coverage of gradual, continuous, and prolonged events that might have been excluded by the instantaneous connotation of 'accident**.'" *Natl. Union Fire Ins. Co. of Pittsburgh, PA v. Turner Constr. Co.*, 119 A.D.3d 103, 2014 NY Slip Op 3607, 986 N.Y.S.2d 74, ¶5 (*citing Uniroyal, Inc. v Home Ins. Co.*, 707 F.Supp. 1368, 1381 (ED NY 1988)).

> [A]mendment of the definition of "occurrence" in the subject commercial liability policies to include the words "event, or happening" along with the word "accident" did not expand the definition so as to encompass faulty workmanship. **The requirement of a fortuitous loss is a necessary element of insurance policies based on either an "accident" or "occurrence" . . . the addition of "event" or "happening" to the definition of "occurrence" did not alter the legal requirement that the "occurrence" triggering the coverage must be fortuitous**. **A claim for faulty workmanship**, in and of itself, **is not an occurrence under a commercial general liability policy because a failure of workmanship does not involve the fortuity required to constitute an accident**."

Id. at ¶4-5 (emphasis added). Thus, the addition of "happening" or "event" to the definition of "occurrence" does not change the fundamental expectation that fortuity is an essential consideration in commercial liability coverage disputes.

Faulty workmanship is always foreseeable

As a matter of law and logic, **faulty workmanship by a subcontractor or a components provider (like Ironics) is <u>always</u> a foreseeable and expected part of their performance that is planned for and addressed through the parties' contracts and, ultimately, warranty laws—which is the very basis of the economic loss rule**. *See Custom Argi Sys.* at ¶18, *citing Essex Ins. Co. v. Holder*, 372 Ark. 535, 261 S.W.3d 456, 459 (2008) ("the contractor's obligation to repair or replace its subcontractor's defective workmanship could not

be deemed unexpected on the part of the contractor, and therefore, failed to constitute an 'event'[5] for which coverage existed under the policy.") and *Ohio N. Univ.* at ¶33 referring to the Court's adoption of the *Essex* reasoning that "faulty workmanship is not an accident; it is a foreseeable occurrence." *See also Design Concrete Founds., Inc. v. Erie Ins. Property & Cas. Co.*, 2014 ILApp(5th) 130353-U, ¶15 ("**The natural and ordinary consequences of an act do not constitute an accident . . . . When the work of the contractor is defective and necessitates repairing that work, there is no 'accident' and no 'occurrence**.'")

F. Umbrella Policies' Business Risk And Economic Loss-Based Exclusions Preclude Recovery For Purely Economic Loss Resulting From Shoddy Workmanship; Otherwise All Contractual Breaches Can Become Converted Into Torts

As mentioned above, in addition to providing extra funds beyond the limits of CGL policies, **umbrella policies often provide coverage for rare or catastrophic types of claims that a CGL policy normally does not cover in the first instance** (*e.g.*, uninsured or underinsured motorist coverage where the primary policy excepts such coverage, or personal injury coverage where only property damage is covered by the CGL)[6]. These policies are available and affordable for businesses and individuals because such claims are rare, and because umbrella policies carefully exclude from coverage all business-type risks and situations that would not properly fall into liability insurance purview[7]. Performance bonds are available to

[5] Of note here is that the use of the term "event" in place of or in addition to "occurrence" in a liability policy definition of a trigger for coverage does not magically do away with the fundamental underlying fortuity concept.

[6] Umbrella coverage is said to "drop down" to provide primary coverage or fill a gap in primary coverage, but not to provide coverage where the primary coverage would have applied but for the application economic loss or the integrated product rule. *See Tscherne v. Nationwide Mut. Ins. Co.*, 8th Dist. Cuyahoga No. 81620, 2003-Ohio-6158, ¶23-24.

[7] It is not accidental that exclusion provisions in a typical umbrella policy occupy just as many, if not more, of policy pages as the coverage provisions. Here, the underlying policy contains 5 pages of coverage provisions and 4.5 pages of exclusions.

cover these extra issues. However, **the new law announced by the Court of Appeals—that umbrella policies must cover pure economic loss resulting from shoddy workmanship—is a radical departure from all legal and logical underpinnings of umbrella polices that will make them inaccessible and unaffordable**.

To create this new law, aside from defying its own conclusions concerning the economic loss rule and the integrated product concept, the Court of Appeals also read the relevant policy exclusions so narrowly as to essentially read them out of the policy.

"Your product" and "your work" exclusions precludes liability coverage for property damage arising out of contractual performance by the insured

Just like the CGL policy, the umbrella policy excludes coverage for "property damage" to "your product" and "your work" and "arising out of it or any part of it . . . " (Motorists' Appellate Brief at Stipulations000205 at Exclusions i and j). "Your product" is defined "as goods . . . manufactured, sold . . . by you," and "your work" is defined as "work or operations performed by you or on your behalf." (*Id.* at Stipulations000212 at Definitions N and O). Both definitions also unequivocally include "warranties or representations made at any time with respect to fitness, quality, durability or performance" of the "product" or "work."

The trial court properly found that the business exclusions applied. The Court of Appeals declined to apply these clear definitions and found that these exclusions did not apply. But **if Ironics' own product—contaminated tube scale—created through work/operations performed by Ironics, is not sufficient to satisfy the definitions of "your product" or "your work" and preclude recovery for damages "arising out of" such "product" or "work," what possibly can?** If the production and delivery of the tube scale was not the "work" Ironics provided, what contract did it perform? That was its only obligation under the contract.

In essence, **the court below erroneously refused to apply the integrated product concept** it had just adopted with respect to the CGL policy **when considering "your product" and "your work" exclusion of the umbrella policy**.[8] Nevertheless, **other Ohio courts** consistently **find that "your product" and "your work" exclusions indicate the parties' intent that the "replacement or repair of faulty goods or workmanship [to be] a business expense and not an insurable liability**," **where integrated products are concerned**. *Acuity v. City Concrete LLC*, N.D.Ohio No. 4:06CV0415, 2006 U.S. Dist. LEXIS 79720, at *16 (Oct. 17, 2006) (collecting cases and finding that the "your product" exclusion barred coverage for damages associated with replacement or repair or driveways made with defective concrete) (emphasis added). *Acuity v. City Concrete LLC*, N.D.Ohio No. 4:06CV0415, 2006 U.S. Dist. LEXIS 79720, *15-17 (Oct. 17, 2006). **"This exclusion furthers the public policy, commonly accepted in Ohio, that a [liability] policy is not a performance bond."** *Id.* at *17 (emphasis added).

The "impaired product" exception precludes liability coverage for property damage arising out of contractual performance by the insured

The court below also **inexplicably dismissed the "impaired product" exception.** This exception stated that damages associated with property other than "your work" or "your product" that becomes impaired or "less useful" because (1) it incorporates Ironics' non-conforming work or (2) Ironics fails to perform a contract according to its terms, are excluded from coverage. (Motorists' Appellate Brief at Stipulations000205, Exclusion k, and Stipulations000210, Definition E). Relying on another irrelevant part of the "impaired product" definition, the court below reasoned that because Owens' glass "could not be restored to use," the exclusion did not

[8] The Court, on the other hand, found a similar definition of "your product" instructive in *Ohio N. Univ.*, 2018-Ohio-4057, at ¶24-26.

apply. **In essence, the Court of Appeals not only ignored the economic loss in general, it also read out of the umbrella policy all business risk and economic loss rule-based exclusions**.

However, **other courts** interpreting Ohio law correctly **note** that the "**Impaired Property" exclusion precludes coverage for damage to the integrated whole caused by a defective component supplied by the insured in breach of a contract to deliver quality components**. *See e.g. Acuity*, 2006 U.S. Dist. LEXIS 79720, at *20 (the "Impaired Property" exclusion precluded a claim for damage to the value of a house ("impaired property") resulting from defective concrete used in creation of the driveway on the property ("your product")). In essence, even if Ironics were right that Owens' glass incorporating Ironics' contaminated tube scale is not an integrated product, but is "other property" that suffered collateral damage due to Ironics' failure to control its quality, **the "Impaired Property" exclusion clearly "works to exclude collateral damages stemming from [Ironics'] defective product**." *Id.* at *19-20.

By refusing to read this exclusion as it was intended, the **Court of Appeals has now converted umbrella policies into *de facto* performance bonds**, **defeating the key purpose behind business risk exclusions in business liability policies—to discourage careless work by the manufacturer or contractor**. *Erie Ins. Exchange v. Colony Dev. Corp.*, 136 Ohio App.3d 406, 416, 736 N.E.2d 941 (10th Dist. 1999) (**as matter of sound policy, business risk exclusions ensure that damage resulting from the contractor's own work are not covered by liability policies; "[t]his is to discourage careless work by making . . . contractors pay for any losses caused by their own work**"); *Acuity*, 2006 U.S. Dist. LEXIS 79720, at *18 (Oct. 17, 2006) (same).

Umbrella policies would now have to provide coverage in any breach of contract cases where the breaching party did not deliberately breach, because all shoddy or faulty work product

is now just "accidental" and unintended, converting each breach of contract case into a tort action. The Court should not countenance this result.

CONCLUSION

For these reasons, the Court should adopt Appellant's proposition of law, reverse the decision of the Court of Appeals, and adopt the trial court's ruling.

To ensure that no more confusion and discordant determinations occur on this subject, the Court should further expressly announce that, absent clear policy language to the contrary, the economic loss rule and the integrated product rule govern in Ohio regardless of whether a primary CGL, or an umbrella, or another excess liability policy may provide coverage.

Respectfully submitted,

VORYS, SATER, SEYMOUR AND PEASE LLP

By: /s/ *Natalia Steele*

Natalia Steele (0082530)
Vorys, Sater, Seymour and Pease LLP
200 Public Square, Suite 1400
Cleveland, Ohio 44114
Tel: (216) 479-6187
Fax: (216) 937-3755
nsteele@vorys.com

Counsel for Amicus Curiae The Ohio Insurance Institute

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing was served on all counsel of record by electronic mail.

By: /s/ *Natalia Steele*

Natalia Steele (0082530)
200 Public Square, Suite 1400
Cleveland, Ohio 44114
Tel: (216) 479-6187
Fax: (216) 937-3755
nsteele@vorys.com