Mary Haley et al v. Kolbe and Kolbe Millwork Co, Inc. and Fireman's Fund Insurance Company

Year: 2016
Court: U.S. Court of Appeals, 7th Circuit
Case Number: 16-3563/16-3648

A Commercial General Liability ("CGL") policy provides manufacturers, contractors, and subcontractors with insurance coverage if their work or their product is involved in a property damage claim. The insurance industry drafting history confirms this intent and insurance underwriters are well aware that this is the primary risk for which this type of insurance is purchased by these types of businesses in Wisconsin and elsewhere. Under Wisconsin law, however, if there is an "integrated system" whereby one of the components is defective and causes damage to the finished product, there is no insurance coverage. The reason being that one cannot separate the defective ingredient from the finished product (e.g., pharmaceuticals) without starting over. In other words, the "integrated system" itself must cause damage to "other property" before there is coverage. However, take a construction defect scenario: an allegedly defective window leaks and causes damage to the flooring, the walls, etc. The house itself is not an "integrated system" – each part, windows in particular, can be separated and replaced relatively easily. If it was, replacing a window would mean demolishing the entire house. This is distinct from a pharmaceutical tablet where once the ingredients are combined, they cannot be separated. Unfortunately, the District Court wrongly expanded the scope of Wisconsin insurance law to eliminate coverage for leaky windows that cause damage to the house in which they are installed, analogizing the house to an "integrated system." Taken to it's logical conclusion, this would mean that there would only be insurance coverage for leaky windows if they cause damage to the house next door or the Picasso on the wall inside the home. UP urged the 7th Cir. to reverse given that expanding the reasoning of a pharmaceutical cause to a construction defect ignores the realities of the work performed and products

manufactured, improperly makes new law in a federal court sitting in diversity, wrongly applies the economic loss doctrine, goes against a policyholder's reasonable expectations of insurance coverage, and is contrary to the stated public policy of the state Wisconsin. UPdate 8/8/17: The 7th Circuit reversed the District Court's finding that the insurers had no duty to defend and remanded the case. The 7th Circuit held that the insurers here were stretching the Pharmacal "integrated system" holding beyond its intended reach.

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