No. 18-2206

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

SAPA EXTRUSIONS, INC.,
Plaintiff-Appellant,

v.

LIBERTY MUTUAL INSURANCE CO., ET AL.
Defendant-Appellees.

APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF PENNSYLVANIA DATED MAY 1, 2018 IN CIVIL ACTION NO. 1:13-cv-02827

BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS IN SUPPORT OF PLAINTIFF-APPELLANT

John G. Koch
WEISBROD MATTEIS & COPLEY PLLC
Two Logan Square, Suite 1925
100 N. 18th Street
Philadelphia, PA 19103
(215) 883-7419
Attorneys for Amicus Curiae United Policyholders

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Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *Amicus Curiae*, United Policyholders states that it is a non-profit 501(c)(3) charitable organization, and that it does not have a parent corporation or shareholders.

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United Policyholders was founded in 1991 and is a non-profit organization dedicated to educating the public on insurance issues and consumer rights. It protects the interests and presents the positions of policyholders through participation as *amicus curiae* in insurance coverage cases throughout the country. The organization is tax-exempt under Internal Revenue Code § 50l(c)(3) and is funded by donations and grants from individuals, businesses and foundations.

United Policyholders is an information resource on sales, coverage, claims and litigation-related issues pertaining to the full range of personal and commercial lines insurance products. An average of 20,000 monthly visitors read articles and tips at www.unitedpolicyholders.org. The organization participates in proceedings of the National Association of Insurance Commissioners and receives frequent invitations to testify at legislative and other public hearings, and to participate in regulatory proceedings on rate and policy issues.

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United Policyholders has appeared in many cases in the Third Circuit Court of Appeal, including: *Hussey Copper, Ltd. v. Arrowood Indemnity Co.*, 391 F. App'x 207 (3d Cir. 2010); *Weiss v. First Union Life Ins. Co.,* 482 F.3d 254 (3d Cir. 2007); and *Willow Inn, Inc. v. Pub. Serv. Mut. Ins. Co.*, 399 F.3d 224 (3d Cir. 2005).

United Policyholders has also appeared in many Pennsylvania Supreme Court cases, including: *Allstate Prop. & Cas. Co. v. Wolfe* 105 A.3d 1181 (Pa. 2014) (United Policyholder's amicus brief cited throughout); and *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, 131 A.3d 445 (Pa. 2015). A complete listing of all cases in which United Policyholders has appeared as *amicus curiae* can be found m our online Amicus Project library at www.uphelp.org/amicus.

United Policyholders seeks to assist courts as *amicus curiae* in appellate proceedings throughout the United States, particularly in cases such as this one,

which involve insurance principles that are likely to impact a large segment of the public.[1]

[1] This brief is submitted on motion and pursuant to Federal Rule of Appellate Procedure 29(a). No counsel for a party authored this brief in whole or in part. Further, no such counsel or party, or person other than United Policyholders, its members, or United Policyholders' counsel, made a monetary contribution intended to fund the preparation or submission of this brief.

SUMMARY OF ARGUMENT

When policyholders pay premiums for insurance, they have a right to expect something of comparable value in return. The district court subverted that reasonable expectation by conflating a standard product defect claim involving damage to another's property, for which there is coverage, with a contractual faulty workmanship claim for damage to the policyholder's own work. If this Court upholds the decision below, insurers are likely to seize upon it to deny coverage for virtually all product defect claims involving breaches of warranty. This would effectively render products-completed operations coverage illusory in Pennsylvania, especially for insureds without the resources to fight for coverage.

This case must be viewed in context. Commerce in the United States largely consists of businesses buying parts or ingredients from other businesses to make a new part, ingredient or final product. This is commonly known as a supply chain and is the backbone of countless industries. In a typical commercial supply chain, buyers demand that sellers warranty their product and conform to industry standards. Some warranties are imposed by law. Buyers also insist on contractual indemnifications in the event their product is defective.

Product manufacturers and suppliers, in turn, manage the risk of selling a defective product by buying insurance that covers claims falling within what standard commercial general liability ("CGL") insurance policies define as the

"products-completed operations hazard." That is, they buy products coverage for protection if they are sued because their defective part, ingredient or product injured someone or damaged property other than the part, ingredient or product itself. The insurance purchased not only affords protection to the policyholder, but ensures the availability of funds to remedy harm caused to others.

If insurers are permitted to deny coverage for product defect claims by misclassifying them as faulty workmanship or basic contract claims, the detrimental impact to Pennsylvania businesses, especially to smaller businesses, is readily apparent. They will be saddled with product liabilities for which they thought they had coverage, and they will have wasted money they could have used to address the liability on hefty premiums for meaningless, illusory insurance. This Court should reverse the district court and clarify, or certify to the Pennsylvania Supreme Court to clarify, that product defect claims like the one here involving damage to third party property are not faulty workmanship type claims that may fall outside of coverage.

Although there are several grounds for reversing the district court, United Policyholders will focus on the following fundamental errors that would broadly impact Pennsylvania insureds.

First, the district court failed to read the relevant insurance policies as a whole to avoid rendering certain terms meaningless. Specifically, the district court

incorrectly reasoned that it need not consider the definitions of "products-completed operations hazard" and "your product," nor the separate coverage limits assigned to the "products-completed operations hazard," until after it determined there has been an "occurrence" in the first instance. By taking this flawed approach, the district court failed to understand how the term "occurrence" and the products-completed operations provisions of the policy interact.

The products-completed operations coverage that businesses often purchase is included within the standard CGL policy in exchange for significant extra premiums. The coverage is added to the CGL policy typically by removing a standard exclusion that excludes coverage for claims falling within the defined "products-completed operations hazard," or by adding an exception to the exclusion. Separate limits are assigned to account for the additional premium and the particular class of risks the additional insurance is intended to cover, *i.e.*, claims falling within the products-completed operations hazard. If no extra premium is paid, the relevant exclusion will remain in the policy.

When purchased, products-completed operations coverage falls within the general insuring agreement. Thus, it is triggered by an "occurrence." But, the meaning of "occurrence" must be interpreted broadly enough to include claims falling within the products-completed operations hazard. Otherwise, the policyholder would receive nothing of comparable value for the substantial extra

premiums paid to insure claims falling within that hazard. Importantly, a class of claims that is expressly defined to fall within the products-completed operations hazard is a claim for breach of warranty due to a defective product causing bodily injury or property damage.

By failing to consider how the meaning of "occurrence" interacts with the products-completed operations provisions in the policies, the district court reached the flawed conclusion that claims for breach of warranty are necessarily too foreseeable to be an "occurrence" and are in essence contractual claims for faulty workmanship, regardless of unintentional damage to third parties or third party property. This flawed conclusion renders the products-completed operations provisions meaningless and renders illusory coverage for product defect claims falling within the products-completed operations hazard.

Second, the district court's flawed interpretation of "occurrence" defeats the reasonable expectations of Pennsylvania policyholders that pay extra premiums for products liability coverage. Pennsylvania requires that insurance terms cannot be interpreted in a manner that flouts the reasonable expectations of policyholders. This point is particularly poignant because the district court's decision runs contrary to an entire line of products coverage cases in Pennsylvania. It also runs contrary to virtually every other court in the country that has addressed the type of products liability claim at issue here. If not corrected, policyholders' reasonable

expectations will be thwarted and Pennsylvania policyholders will be put at a distinct disadvantage to businesses in other states, which are able to manage products liability risk through meaningful insurance coverage for claims within the products-completed operations hazard.

Third, when analyzing whether any underlying allegations could potentially trigger the broad duty to defend, the district court perfunctorily dismissed allegations of damage to property other than the insured's own product. The district court thus failed to view several underlying allegations in a light most favorable to the insured, resolving all doubts in favor of coverage. It also ignored well-established decisional law stating that when a defective product is incorporated into a new product and damages it, the damage to the new product constitutes damage to third party property. If upheld, the district court's extremely narrow view of the underlying allegations would improperly erode the broad duty to defend otherwise extended to insureds in Pennsylvania and elsewhere.

ARGUMENT

I. THE DISTRICT COURT FAILED TO INTERPRET THE INSURANCE POLICIES AS A WHOLE AND RENDERED PRODUCTS LIABILITY COVERAGE ILLUSORY IN PENNSYLVANIA

In the proceedings below, the district court interpreted the policy term "occurrence" in a vacuum, giving no regard to what the insurance industry actually intended when it began to offer insurance coverage for products liability in the

standard CGL policy. That intent is evident from the drafting history of the products-completed operations hazard provisions in the CGL policy and how that provision operates within the policy, particularly regarding the term "occurrence." This resulted in an interpretation of "occurrence" that defies the intent of the parties, renders the products-completed operations provisions meaningless, and renders coverage for product liability claims illusory. Furthermore, the district court's decision is at odds with *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. 2006), and an entire line of Pennsylvania products liability coverage cases recognizing that when a defective product malfunctions, causing damage to other property, there is an "occurrence" triggering coverage.

A. Pennsylvania's Principles of Insurance Contract Interpretation

The goal of courts interpreting insurance policies is "to ascertain the intent of the parties as manifested by the language of the written instrument." *Madison Constr. Co. v. Harleysville Mut. Ins. Co.*, 735 A.2d 100, 106 (Pa. 1999). To ascertain the parties' intent, a "court must read the policy 'as a whole and construe[ ] [it] according to the plain meaning of its terms.'" *Ramara, Inc. v. Westfield Ins. Co.*, 814 F.3d 660, 676 (3d Cir. 2016) (quotation omitted, alteration original, applying Pennsylvania law). It is a "cardinal principle of interpretation that an insurance policy must be construed in such a manner as to give effect to all of its

provisions" without rendering any term "meaningless surplusage." *Mut. of Omaha Ins. Co. v. Bosses*, 237 A.2d 218, 220 (Pa. 1968)). Ambiguous terms must be construed in favor of the insured. *Madison Constr. Co.*, 735 A.2d at 106 (citation omitted).

Any interpretation of an insurance policy must accord with the policyholder's reasonable expectation of coverage. *Reliance Ins. Co. v. Moessner*, 121 F.3d 895, 898, 906-08 (3d Cir. 1997). When determining the intent of the parties, course of performance or "custom in the industry or usage in the trade is always relevant and admissible in construing commercial contracts and does not depend on any obvious ambiguity in the words of the contract." *Sunbeam Corp. v. Liberty Mut. Ins. Co.*, 781 A.2d 1189, 1193 (Pa. 2001).

B. The History, Structure and Purpose of the Products-Completed Operations Hazard in the CGL Policy

The "development of insurance protection for products liability, denominated 'Products Hazard' coverage, has paralleled the development of the modern rules for products liability." Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations; What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 416 (1971) ("Henderson") (cited in *Kvaerner*, 908 A.2d at 899 n.10). Prior to modern products liability law, the typical CGL policy was generally focused on covering "bodily injury" or "property damage" taking place on the insured's premises or during the insured's ongoing operations, called

"Premises and operations" coverage. *Id.* at 417. With the development of new theories of liability, businesses became exposed to liability when their products caused harm after they were sold, or harm arose out of their work after operations were completed. *Id.*

Responding to the development of products liability law, the insurance industry added to the standard CGL policy new definitions describing the new products liability risks, which the industry called the "products hazard" and which eventually became the "products-completed operations hazard." *See id.* at 418; *see also* Robert M. Landis and Mark C. Rahdert, *The Completed Operations Hazard*, 19 The Forum (ABA, Section of Insurance, Negligence and Compensation Law) Vol. 4, at 570, 571 (Summer 1984) ("Landis"). By adding the new provisions, the insurance industry was able to classify the coverage afforded by the CGL policy pertaining to "bodily injury" and "property damage" into two basic categories: losses occurring on the insured's premises or arising from its operations on the one hand, and on the other losses arising from products after they are sold or operations after they are completed. *See* Henderson, 50 NEB. L. REV. at 418; *see also Friestad v. Travelers Indem. Co.*, 393 A.2d 1212, 1214 (Pa. Super. Ct. 1978); Landis, 19 The Forum Vol. 4, at 571-72. Having categorized the types of losses or hazards, the insurance industry charged a substantial additional premium for those who wanted coverage for claims falling within the newly defined products hazard.

Friestad, 393 A.2d at 1214 ("the development of the law of products liability insurance has witnessed the insurance companies' efforts to draft its…policies, first, to provide such liability coverage for those who wished to purchase it, and second, to segregate the hazards, and consequently the premiums charged therefor, which arose from either the manufacture, sale, handling or use of a product…."); Henderson, 50 NEB. L. REV. at 418; Landis, 19 The Forum Vol. 4, at 571-72.

If an insured wanted such products coverage, it had "to be specifically purchased by the insured by so electing on the face of the policy or by purchasing an endorsement which either adds the coverage to or deletes the exclusion of the coverage under the basic policy." Henderson, 50 NEB. L. REV. at 418; *see also* 3 Insurance Claims and Disputes § 11:20 (6th ed.); Landis, 19 The Forum Vol. 4, at 571-72 (same). "The intent was to ensure the insurance companies would not assume financial responsibility for the additional risks associated with products liability unless they were remunerated for doing so." Landis, 19 The Forum Vol. 4, at 571-72; *Friestad*, 393 A.2d at 1214; *Baker v. Nat'l Interstate Ins. Co.*, 180 Cal. App. 4th 1319, 1337 (2009).

In addition, insurers created separate per occurrence and aggregate insurance limits for claims falling within the products-completed operations hazard. *See* Insurance Coverage of Construction Disputes § 4:4 (2d ed.); *Friestad*, 393 A.2d at 1213. This allowed insurers to underwrite the hazards differently and charge

different premiums to correspond to the separate limits provided for each hazard. *See Friestad*, 393 A.2d at 1213; Landis, 19 The Forum Vol. 4, at 571-72. The appearance of a separate per occurrence limit for claims falling within the products-completed operations hazard is one form in which coverage for claims falling within the products-completed operations hazard can be purchased. Insurance Coverage of Construction Disputes § 4:4 ("Liability policies often contain either an exclusion for injury encompassed by a so-called completed operations hazard, or a separate policy limit for claims encompassed by the completed operations hazard."); *Friestad*, 393 A.2d at 1213-14.

Modern standard CGL policies still follow this basic structure in that coverage for claims falling within the products-completed operations hazard is purchased for an additional premium; if no premium is paid, the coverage will be excluded. *See* 9A Couch on Ins. § 129:25. Thus, if there is an "occurrence" falling within the products-completed operations hazard, it will be covered so long as the insured paid the additional premium for claims falling within that hazard and it is not otherwise excluded. *See Moessner*, 121 F.3d at 898, 906-08.

The Pennsylvania Supreme Court explicitly approved of the following description of risks that products liability insurance was designed to cover, provided by Professor Henderson in an oft-cited law review article:

> the risk intended to be insured 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.

Kvaerner, 908 A.2d at 899 n.10 (quoting Henderson, 50 NEB. L. REV. at 441 (emphasis added)). Professor Henderson was sure to explain that the products hazard "will protect against defective products, breached warranties and misrepresentations…." Henderson, 50 NEB. L. REV at 426. That is because, as explained below, the products-completed operations hazard and related policy terms expressly include warranty claims arising out of a defective product.

The inclusion of breach of warranty claims in the products-completed operations hazard corresponds to the development of products liability law allowing claims for beaches of warranties implied by law to '"protect buyers from loss where goods purchased are below commercial standards or unfit for the buyer's purpose."' *Goodman v. PPG Indus., Inc.*, 849 A.2d 1239, 1245 (Pa. Super. Ct. 2004), *aff'd,* 885 A.2d 982 (Pa. 2005) (quotations omitted). Indeed, the Pennsylvania Supreme Court has "harmonized the rules governing implied warranty claims with the rules governing products liability claims, because the two types of actions are now substantially similar." *Id.*

C. The Meaning of "Occurrence" Must Give Effect to the "Products-Completed Operations Hazard" and Related Terms as Defined in the Applicable Insurance Policies

The district court erred by interpreting "occurrence" so narrowly that it would never include a breach of warranty claim, rendering certain policy terms

meaningless and products coverage illusory. Specifically, the district court misinterpreted the Pennsylvania Supreme Court's holding in *Kvaerner* by concluding that breach of warranty claims are by their very nature too foreseeable to be an occurrence. (A34.) To the contrary, the relevant drafting history plainly demonstrates that the insurance industry intended the term "occurrence" to include breach of warranty claims falling within the products-completed operations hazard, subject to an exclusion if a policyholder elected not to pay the extra premium for such coverage.

In the case at hand, there is no dispute that Appellant Sapa Extrusions, Inc. ("Sapa") paid extra premiums to insure against claims falling within the products-completed operations hazard, as evidenced by the inclusion of a separate per occurrence limit for claims falling within that hazard. (*See, e.g.,* A1061.) The term "Products-Completed Operations Hazard" is typically defined in the CGL policy as "Bodily Injury and Property Damage occurring away from the premises you own or rent and arising out of Your Product or Your Work." (*See, e.g.*, A1069.) The term "Your Product" is typically defined as:

> Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by…you….
>
> Your Product ***includes***:
>
> 1. ***Warrantees or representations made at any time with respect to the fitness, quality, durability, performance or use of Your Product***; and . . . .

(*See* A1069-1070 (emphasis added).) Plainly, the products-completed operations hazard includes claims alleging that a policyholder breached a warranty by selling a defective product that injured the claimant or damaged the claimant's property beyond the product itself.

The term "occurrence" in CGL policies is not always defined the same way. Some CGL policies define it as "an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage neither expected nor intended from the standpoint of the Insured." (*See, e.g.*, A892.)

When reading the above "occurrence" definition in light of the "Your Product" and "Products-Completed Operations Hazard" definitions, and considering the drafting history out of which these provisions arose, it is clear that the insurance industry *intended to provide coverage for breach of warranty and misrepresentation claims* alleging that a defective product caused bodily injury or damage to property other than the product itself, so long as an extra premium was paid. *See, e.g.*, Henderson, 50 NEB. L. REV. at 426 (stating the products hazard "will protect against defective products, breached warranties and misrepresentations…."); *Indalex Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 83 A.3d 418, 426 (Pa. Super. Ct. 2013).

If, as the district court suggests (*see* A34), breach of warranty claims are really breach of contract claims that are never an occurrence because the harm is

too foreseeable to be unexpected or unintended, there would be no reason to include breach of warranty claims in the definition of "Your Product." Similarly, the reference to "Your Product" in the definition of the "Products-Completed Operations Hazard" would be superfluous with respect to the breach of warranty and misrepresentation claims included within the definition of "Your Product."

Most importantly, the district court's interpretation of "occurrence" would render the separate insurance limits tied to the products-completed operations hazard illusory because such limits could never be used to pay a breach of warranty judgment, even if the cause of the breach was a defective product that caused bodily injury or damage to other property. That is, the extra premium paid to cover liability arising out of "Your Product" would buy phantom coverage, since an entire class of claims for which it was purchased, breach of warranty claims in the definition of "Your Product," would never actually trigger the indemnity obligation in the first place. Because products liability claims are often predicated on breach of warranty causes of action, an overly narrow definition of occurrence would significantly eliminate coverage for products liability claims. *See Goodman*, 849 A.2d at 1245; *see also Jones v. SEPTA*, 834 F. Supp. 766, 769 (E.D. Pa. 1993) ("the reach of product liability and breach of warranty actions are "co-extensive").

Furthermore, the policies' exclusions for damage *to* "Your Product" or "Your Work," commonly referred to as the business risk exclusions, would be superfluous. These exclusions are designed to ensure that products liability insurance does not become a performance bond by insuring a party's performance under a contract. *See, e.g.*, Henderson, 50 NEB. L. REV. at 441. As the Pennsylvania courts recognize, "[e]xclusions, by their very nature, are designed to operate to deny coverage that otherwise would be provided under the definition of an occurrence." *Donegal Mut. Ins. Co. v. Baumhammers*, 893 A.2d 797, 819 (Pa. Super. Ct. 2006) *aff'd in part by,* 938 A.2d 286 (Pa. 2007). There would be no need for these business risk exclusions unless claims for breach of contract and breach of warranty could be an "occurrence" in the first instance. The Wisconsin Supreme Court aptly explained this principle in the specific context of the "business risk" exclusions:

> If…losses actionable in contract are never CGL "occurrences" for purposes of the initial coverage grant, then the business risk exclusions are entirely unnecessary….If the insuring agreement never confers coverage for this type of liability as an original definitional matter, then there is no need to specifically exclude it. *Why would the insurance industry exclude damage to the insured's own work or product if the damage could never be considered to have arisen from a covered "occurrence" in the first place?*

Am. Family Mut. Ins. Co. v. Am. Girl, Inc., 673 N.W.2d 65, 78 (Wis. 2004) (emphasis added).

In light of the foregoing, the district court's refusal to consider how "occurrence" interacts with the products-completed operations provisions contravenes fundamental principles of insurance contract interpretation and impermissibly renders coverage illusory.

D. The Pennsylvania Supreme Court's *Kvaerner* Decision Does Not Support the District Court's Overly Narrow Interpretation of "Occurrence"

The genesis of the district court's flawed interpretation of "occurrence" appears to come from its misreading of *Kvaerner*. *Kvaerner* involved a policy that defined "occurrence" as an "accident…," which the policy did not further define (unlike several policies at issue here). 908 A.2d at 892. The court adopted the dictionary definition of accident, which is an "unexpected and undesirable event." *Id.* at 897-98. The court explained the "key term in the ordinary definition of 'accident' is 'unexpected.'" *Id.* at 898. The court further explained an event is an unexpected accident, or occurrence, '"if the insured work or product actively malfunctions, causing injury to an individual or damage to another's property"' *Id.* (internal quote omitted); *see also Indalex*, 83 A.3d at 424.

Critically, the *Kvaerner* court was sure to explain that "a CGL policy *may provide coverage where faulty workmanship caused bodily injury or damage to another property*, but not in cases where faulty workmanship damages the work product alone." *Kvaerner*, 908 A.2d at 898 (emphasis added) (citing with approval

L-J, Inc. v. Bituminous Fire and Marine Ins. Co., 621 S.E.2d 33 (S.C. 2005)). Against this backdrop, *Kvaerner* held merely that allegations of construction defects and "workmanship related irregularities" *that caused damage only to the insured's work itself* were not an "accident" because they lacked the "degree of fortuity" required to be something that is "unexpected" by the insured. *Id.* at 897-89, 900.

The insurance industry has incorrectly sought to use *Kvaerner* to deny coverage for claims involving product defects in Pennsylvania whenever a complaint includes a breach of contract or warranty claim, regardless of allegations of a product defect and third party property damage. This has led to confusion among Pennsylvania courts at the expense of policyholders.

In *Indalex*, the Pennsylvania Superior Court provided much needed clarity. There, the court recognized the difference between providing a sub-standard service (faulty workmanship) that does not damage other people or property, and providing a defective "product that failed" causing damage to other property. *Indalex*, 83 A.3d at 424. The court explained that "a bad product…can be construed as an 'active malfunction' and not merely bad workmanship." *Id.* That is, when a defective product malfunctions, causing damage to other property, it is not necessarily too foreseeable to be unexpected or unintended. *Id.* Accordingly, claims for breach of warranty for providing a "bad product" causing damage to

other property can constitute an "occurrence," which is perfectly consistent with *Kvaerner*. *Id.*

In the same year the Pennsylvania Supreme Court denied *certiorari* in *Indalex*, 99 A.3d 926 (Pa. 2014), it implicitly recognized that a claim for damage to dairy cows caused by defective PVC piping and the faulty installation thereof was an occurrence. *See Pa. Nat. Mut. Cas. Ins. Co. v. St. John*, 106 A.3d 1, 3, (Pa. 2014). The court affirmed that the above claim triggered coverage under one of four successive occurrence-based CGL policies at issue, which would necessarily require an "occurrence." *Id.* Of note, the underlying claimant "hired" the insured to procure and install the PVC piping. *Id.*

In addition, there is an entire line of cases recognizing that breach of warranty type claims arising from defective products that damaged other property can constitute an "occurrence" in Pennsylvania. *See, e.g.*, *Nat'l Fire Ins. Co. of Hartford v. Robinson Fans Holdings, Inc.*, No. 10-cv-1054, 2011 WL 1327435, at *1-5 (W.D. Pa. Apr. 7, 2011); *Berg Chilling Sys. Inc. v. Hull Corp.*, 70 F. App'x 620, 624 (3d Cir. 2003); *Lang Tendons, Inc. v. N. Ins. Co. of N.Y.,* No. 00-cv-2030, 2001 WL 228920, at *1-8 (E.D. Pa. Mar. 7, 2001); *Moessner*, 121 F.3d at 903; *Imperial Cas. And Indem. Co. v. High Concrete Structures, Inc.*, 858 F.2d 128, 134-35 (3d Cir. 1988); *Arcos Corp. v. Am. Mut. Liab. Ins. Co.*, 350 F. Supp. 380, 382-84 (E.D. Pa. 1972), *aff'd*, 485 F.2d 678 (3d. Cir. 1973); *Bowman Steel Corp.*

v. Lumbermens Mut. Cas. Co., 364 F.2d 246, 248-50 (3d Cir. 1966); *Pittsburgh Plate Glass Co. v. Fidelity & Cas. Co. of N.Y.*, 281 F.2d 538, 539-42 (3d Cir. 1960).

Accordingly, the district court's narrow interpretation of "occurrence"—which categorically excludes breach of warranty claims on the ground that damage arising from such a breach is too "foreseeable"—is not at all compelled by *Kvaerner* or Pennsylvania law. The following hypothetical illustrates the district court's departure from *Kvaerner* and the flaw in its reasoning.

Suppose a homeowner with a Marvin Lumber ("Marvin") window cut herself on an oxidized surface of the window where one of Sapa's extrusions was incorporated. The homeowner sues Sapa directly, alleging that it breached implied warranties by failing to manufacture its extrusions in accordance with industry standards, resulting in premature oxidation. Under the district court's reasoning, there would be no "occurrence" because it would be too foreseeable that a failure to follow industry standards during manufacturing would result in premature oxidation (the defect or active malfunction) that caused the injury, just as it would be too foreseeable that the oxidation would cause property damage to Marvin's windows and doors. This is a clear departure from *Kvaerner* and *St. John*, which acknowledged that faulty workmanship claims and product defect claims may

amount to an "occurrence" if accompanied by bodily injury or damage to other property. *See Kvaerner*, 908 A.2d at 898.

From a coverage standpoint, there is no valid distinction between Sapa breaching an implied warranty owed to a third party resulting in injury or damage to other property, which is plainly covered, versus Sapa breaching an implied warranty owed to Marvin resulting in damage to Marvin's windows and doors (*i.e.*, property other than the extrusions themselves). *See Goodman*, 849 A.2d at 1245 (noting that Pennsylvania has "harmonized" products liability claims for breach of implied warranty claims); *Indalex*, 83 A.3d at 424; *St. John*, 106 A.3d at 1, 3. The existence of a contractual relationship between the claimant and the insured neither changes the nature of the accident itself nor the cause of the accident, or whether an implied warranty was breached. Nor does it automatically make the accident "foreseeable." Surely it cannot be said that a breach of implied warranty claim arising from the same event caused by the same conduct would be covered in one instance but not in another. Nothing in the definition of occurrence permits such an inconsistency.

When brought to its logical conclusion, the district court's sweeping foreseeability analysis would swallow products liability coverage whole. *See, e.g.*, *Phibro Animal Health Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 142 A.3d 761, 767 (N.J. App. Div. 2016) ("a prudent individual who purchases insurance in

case some form of accident might occur in the future does not lose that protection just because he or she can 'foresee' in the abstract a possible need for coverage. If foreseeability were construed that broadly to disallow coverage, then no sensible person would ever pay a premium."), *cert. denied*, 154 A.3d 698 (N.J. 2016). If foreseeability is to have any role in determining whether an occurrence has taken place, the issue of whether the damage was too foreseeable to the insured must be resolved by a trier of fact. It should not be resolved on the pleadings alone by the categorical rule espoused by the district court.

Furthermore, the district court's overly narrow interpretation of "occurrence" puts Pennsylvania in an extreme minority among other jurisdictions. *See* Christopher C. French, *Revisiting Construction Defects as 'Occurrences' Under CGL Insurance Policies*, 19 U. PA. J. BUS. L. 101, 122-23 (2016) (collecting cases); *Black & Veatch Corp. v. Aspen Ins. Ltd.*, 882 F.3d 952, 966 (10th Cir. 2018) (same). This extreme minority position is not compelled by *Kvaerner* and is at odds with the terms of the CGL policy.

II. THE DISTRICT COURT'S INTERPRETATION OF "OCCURRENCE" CONTRAVENES THE INSURED'S REASONABLE EXPECATIONS

The district court erred by failing to even consider the doctrine of the insured's reasonable expectations, and instead artificially divorced this claim from the real world. Specifically, the district court ignored the business environment out

of which this claim arose, which illustrates why businesses purchase products liability insurance and what they believe they are buying. The district court also ignored the reasonable expectations created by the Appellee insurers' own conduct.

In Pennsylvania, "the proper focus for determining issues of insurance coverage is the reasonable expectations of the insured." *Moessner*, 121 F.3d at 903. The doctrine requires courts to interpret insurance policies to meet the reasonable expectations of both unsophisticated and sophisticated policyholders alike. *Koken v. Legion Ins. Co.*, 831 A.2d 1196, 1247 (Pa. Commw. Ct. 2003) (rejecting notion that '"sophisticated' policyholders are less deserving than others and, thus, prime candidates for having their contractual expectations compromised."), *aff'd sub nom.*, *Koken v. Villanova Ins. Co.*, 878 A.2d 51 (Pa. 2005); *see also Tonkovic v. State Farm Mut. Auto. Ins. Co.*, 521 A.2d 920, 926 (Pa. 1987) ("the public has a right to expect that they will receive something of comparable value in return for the premium paid."). "Courts must examine 'the totality of the insurance transaction involved to ascertain the reasonable expectations of the insured." *Moessner,* 121 F.3d at 903 (quotation omitted).

Given the preceding discussion, it is difficult to envision how the insured, or any insured, would not reasonably expect coverage in this case. Sapa buys products from other businesses, for example coatings for its extrusions, and incorporates that product into its own products (extrusions). It then sells its

extrusions to Marvin, which incorporates them into its products, doors and windows. Marvin then sells its products to wholesalers or contractors, who sell and install them in homes. As a manufacturer in a supply chain, Sapa is at risk of being sued if its products are defective. Manufacturers like Sapa manage this risk through insurance, specifically, by paying hefty extra premiums so that claims falling within the products-completed operations hazard are covered under their CGL policies. *See, e.g.*, Raymund C. King and David J. Meltzer, *Products-Completed Operations Hazards Coverage*, ABA-TMOLDL § 6.05 (2008); 9A Couch on Ins. § 129:25.

When manufacturers like Sapa pay substantial extra premiums for products-completed operations coverage, which explicitly includes breach of warranty claims, they expect protection when sued under breach of warranty theories for a defective product that causes damage to other property. *See, e.g.*, *J.H. France Refractories Co. v. Allstate Ins. Co.*, 578 A.2d 468, 476 (Pa. Super. Ct. 1990) ("any manufacturer who is operating with liability coverage has a reasonable expectation that any liability, reasonably encompassed within the policy, which is tied to that manufacturing and distributing process will be covered" because "that is the primary reason the policy was purchased in the first place."), *aff'd in part, rev'd in part on other grounds*, 626 A.2d 502 (Pa. 1993); *Bishops, Inc. v. Penn Nat'l Ins.*, 984 A.2d 982, 993 (Pa. Super. Ct. 2009) ("No insured would purchase extra

coverage for an added premium in the expectation that its claim under that coverage would be denied…."); *Peters v. Nat'l Interstate Ins. Co.*, 108 A.3d 38, 49 (Pa. Super. Ct. 2014) (same).

In fact, the underwriting file produced in the underlying matter is replete with examples of the defendant insurers providing coverage for products liability claims similar to the one at issue here. (*See* A4418, A4424.) This only reinforced Sapa's expectation of coverage for product defect claims.

The district court's interpretation of "occurrence" flies in the face of Sapa's reasonable expectations. Specifically, the district court's conclusion that all breach of warranty claims are too "foreseeable" would swallow coverage whole, especially when the claim is brought by a member of the supply chain in privity with the insured—something that is commonplace in the real world. It also puts Pennsylvania businesses at a distinct disadvantage to businesses in almost every other state in the country, which have interpreted the term "occurrence" more in line with an insured's reasonable expectations in the context of breach of warranty claims involving defective products. *See* Christopher C. French, 19 U. PA. J. BUS. L. at 122-23.

This could encourage Pennsylvania businesses to move to jurisdictions where they can better manage their risks, instead of paying extra premiums to protect against product defect claims only to be told by their insurers that what

they are really being sued for is faulty workmanship, which the insurers purport is not covered in Pennsylvania.

III. THE UNDERLYING COMPLAINT CONTAINS ALLEGATIONS OF DAMAGE TO OTHER PROPERTY CAUSED BY A PRODUCT DEFECT, TRIGGERING THE DUTY TO DEFEND

The duty to defend is triggered if there is any possibility that any allegation, even if groundless, could potentially fall within coverage. *See Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.,* 2 A.3d 526, 541 (Pa. 2010) ("As long as the complaint 'might or might not' fall within the policy's coverage, the insurance company is obliged to defend."). The "'factual allegations of the underlying complaint against the insured are to be taken as true *and liberally construed in favor of the insured*'" with all doubts resolved in the insured's favor. *Id.* (quotation omitted) (emphasis added).

In Pennsylvania, when a defective product is incorporated into a new product of greater value, resulting in damage to the new product, the damage to the new product constitutes damage to third party property. *See, e.g.*, *High Concrete Structures, Inc.*, 858 F.2d at 134-35; *Pittsburgh Plate*, 281 F.2d at 539-42.

In its opinion, the district court explicitly acknowledged that Sapa's extrusions were "incorporated into Marvin's" doors and windows. (A53.) The underlying complaint alleges that "*the surface finish of some of Marvin's windows and doors* made with Sapa's organically coated extruded aluminum profiles has

prematurely failed in coastal installations." (A153 (emphasis added).) It also alleges that Marvin incurred significant costs "repairing and/or replacing Sapa's organically extruded aluminum profiles" and "in investigating and responding to customer complaints," which resulted in "*non-economic* losses to Marvin." (A153 (emphasis added).)

When construed liberally in favor of coverage, it can be reasonably gleaned from these allegations that Marvin was seeking damages for the cost of having to rip out from customers' homes its windows and doors that were damaged by incorporating allegedly defective extrusions, and then replacing the damaged windows and doors with good ones. Indeed, entire doors and windows needed to be replaced, not just the extrusions themselves. (A4500, A4512, A4522.) This constitutes damage to property other than Sapa's own product. That is, the defective extrusions incorporated into the doors and windows *were* the damage to the doors and windows, which are not Sapa's own product. *See Concrete Structures, Inc.*, 858 F.2d at 134-35.

Accordingly, there is at least a possibility that the allegations "may or may not be covered," triggering the duty to defend. At the very least, whether the allegations conceivably include claims for damage to third party property raises a material dispute of fact inappropriate for resolution by summary judgment. The

district court's unduly narrow view of the pleadings poses the danger of eroding the broad duty to defend contrary to Pennsylvania law.

CONCLUSION

For the foregoing reasons, the district court should be reversed. Alternatively, this Court should certify the issues to the Pennsylvania Supreme Court to clarify the meaning of "occurrence" in cases involving product defects and third party property damage.

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Respectfully submitted,

By: */s/ John G. Koch*

John G. Koch
Weisbrod Matteis & Copley PLLC
Two Logan Square, Suite 1925
100 N. 18th Street
Philadelphia, PA 19103
T: (215) 883-7419
jkoch@wmclaw.com

COMBINED CERTIFICATIONS

Bar Membership: I hereby certify that the undersigned counsel for *amicus curiae* United Policyholders is admitted to practice before this Court.

Word Count, Typeface and Type Style: I hereby certify that this brief complies with the type-volume limitations of Rules 29(a)(5) and 32(a)(7)(B) of the Federal Rules of Appellate Procedure. This brief contains 6,442 words, excluding the parts of the brief exempted by Rule 32(f) of the Federal Rules of Appellate Procedure.

Paper Copies and Virus Detection (L.A.R. 31.1(c)): I hereby certify that the text of the electronic version of this brief is identical to the text in the paper copies that will be submitted to the Court. I further certify that a virus detection program, Microsoft Forefront Endpoint Protection, Version 4.5216.0, updating daily at 2:00a.m., has been run and according to the program, no virus was detected on the electronic copy of this brief.

Service: I hereby certify that on November 26, 2018, I served the foregoing Brief of Amicus Curiae United Policyholders in Support of Plaintiff-Appellant by filing the document on the Court's CM/ECF system, which will provide a Notice of Electronic Filing to all counsel of record in accordance with L.A.R. Misc. 113.4. I further certify that, as required, on November 27, 2018, I will submit the required number of copies of this brief to the Clerk of this Court in accordance with

L.A.R. 31.1(a).

/s/ John G. Koch
John G. Koch
Attorneys for Amicus Curiae United Policyholders