

BINDING AUTHORITY

Insurance Coverage Decisions: Issued Today - Impact Tomorrow



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Policyholders to *Gambone*: We've Got to Stop Meeting Like This

Ordinarily I would not discuss a case in *Binding Authority* involving an issue that had been addressed just one month earlier. But as long as *Gambone* continues to be the Susan Boyle of Pennsylvania insurance coverage law, any news about the case on everyone's lips can't be ignored.

So if Pennsylvania construction defect coverage is of interest to you, read on. If not. Sorry. Just treat this e-mail as if I were the nephew of the exiled King of Nigeria and I need your kind sir's assistance getting His Majesty's fortune out of the country.

Yesterday the Superior Court of Pennsylvania issued a published opinion in *Erie Insurance Exchange v. Abbott Furnace Company*. Before the court was coverage for a defective furnace sold by the insured. The furnace was very specialized and hi-tech. The purchaser's exact purpose for it was way over my head ("produce[] highly sensitive metallic magnetic laminations used in the ground fault industry"). *Abbott Furnace* at 2.

In any event, long story short, whatever this furnace was supposed to do, it didn't -- despite the insured having provided an assurance to the purchaser that it had designed and manufactured similar furnaces for the purchaser's competitors and they had never experienced any problems. The insured finally corrected the problems, but not before the purchaser sustained various financial damages (lost profits, market share, unfulfilled orders), as well as the cost of laminations that had to be destroyed. *Id.* at 2-3.

The opinion is not crystal clear on the procedure, but it appears that the parties settled the underlying suit and the insured sought coverage from Erie. Erie denied coverage based on the lack of an "occurrence." Coverage litigation ensued and the trial court agreed with Erie that it had no duty to defend or indemnify.

The Pennsylvania Superior Court affirmed. While the court did not cite *Gambone*, it just as easily could have. Instead, the Superior Court resolved the issues based on *Gambone*'s older brother -- the Pennsylvania Supreme Court's decision in *Kvaerner*. But since the insured sought coverage based on the purchaser's allegations that the defective furnace had caused damage to property other than the furnace itself (i.e. its laminations), *Abbott Furnace* is a "*Gambone* case," whether the decision was cited or not.

The Superior Court described its task for resolving the coverage question as follows: "[C]ontractual claims of poor workmanship do not constitute the active malfunction needed to establish coverage under a general liability policy. See *Kvaerner Metals Div. of Kvaerner United States, Inc.*, at 333, 908 A.2d at 898 (citation omitted) (emphasis added). Accordingly, we look to the language of IMI's second amended complaint to determine if it pleaded a negligence claim that alleged the furnace actively malfunctioned, directly and proximately causing destruction of and damage to IMI's laminations." *Abbott Furnace* at 8 (emphasis in original).

For purposes of making this determination, the Superior Court turned to Pennsylvania's "gist of the action" doctrine. Namely, "When a plaintiff alleges that the defendant committed a tort in the course of carrying

out a contractual agreement, Pennsylvania courts examine the claim and determine whether the ‘gist’ or gravamen of it sounds in contract or tort. ... The critical conceptual distinction between a breach of contract claim and a tort claim is that the former arises out of ‘breaches of duties imposed by mutual consensus agreements between particular individuals,’ while the latter arises out of ‘breaches of duties imposed by law as a matter of social policy.’” *Id.* at 9-10 (citations omitted).

The Superior Court concluded that, despite the complaint’s allegations of negligence, the gist of the action was contract:

Although IMI did reference Appellant’s negligence in Count VI of its second amended complaint, we find, as did the trial court, that a negligence claim was not adequately pleaded in this instance.

IMI’s claim that Appellant had a duty to apprise IMI of the design defects experienced by IMI’s competitor or, at least, had a duty to not design the furnace in the identical or similarly defective manner arose from the mutual agreement between the parties regarding the specific requested purpose and design of the furnace.

Specifically, before ordering a furnace from Appellant, IMI advised Appellant of its specific needs and intended use. The damage to IMI’s laminations resulted from Appellant’s contractual breach in failing to design the furnace in accordance with IMI’s requested needs and intended use. This is not a situation in which the tortious conduct was the “gist” of the action and the contract was merely collateral to the conduct.

Id. at 10-11.

The take-away point from *Abbott Furnace* is that there is now the existence of a clear statement that Pennsylvania’s “gist of the action” doctrine also has a place at the table when *Kvaerner* and *Gambone* are being served.

If you have any questions (other than about the production of highly sensitive metallic magnetic laminations used in the ground fault industry), please let me know.

A copy of the Superior Court of Pennsylvania’s May 13 decision in *Erie Insurance Exchange v. Abbott Furnace Company* is attached.

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