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To Be or Not to Be – an Insured Contract: Coverage for Breach of Warranty Claims

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In *Bituminous Casualty Corporation v. Plano Molding Company*, 2015 IL App (2d) 140292, the Illinois Appellate Court tackled one of the most misunderstood issues in the commercial general liability policy: does an obligation to indemnify trigger insurance coverage. I thought the Illinois Supreme Court got it wrong in *Virginia Surety v. Northern Insurance*, 224 Ill. 2d 550 (2007), and I still think it got it wrong based on how the Bituminous v. Plano decision applied Virginia Surety. Although the facts are not typical for most general liability disputes, the analysis and reasoning of the court are helpful in understanding this pesky part of the policy.

At issue was a clause in a bill of lading issued by Plano, a manufacturer of storage boxes, in which it agreed to indemnify K-Line, a railroad carrier who was shipping the merchandise, "for any injury, loss or damage caused by breach of warranty" that the cargo being shipped was "safe and proper and suitable for handling and carriage." The Seventh Circuit initially ruled that K-Line had a contractual cause of action for breach of warranty against Plano under the bill of lading. See Kawasaki Kisen Kaisha, Ltd., v. Plano Molding Co., 696 F.3d 647 (7th Cir. 2012). It recently affirmed summary judgment in Plano's favor, however, finding that K-Line could not sustain its burden of proof under maritime law to prove that Plano breached the warranty. *Kawasaki Kisen Kaisha, Ltd., v. Plano Molding Co.*, No. 14-1177 (7th Cir. 3/31/2015).

The question in the coverage action, however, was whether or not Plano's ("Merchant") promise to indemnify K-Line ("Carrier") in the bill of lading qualified as an "insured contract" under Plano's CGL policy issued by Bituminous. If it did, then Bituminous would owe Plano a duty to defend and indemnify for the breach of warranty claims brought by the shipper. Wait? What? Did I just suggest that a CGL policy has coverage for breach of warranty claims? Absolutely, it does. Here's how the reasoning goes.

Plano manufactures large plastic molds. The molds are produced in China and shipped to the US, and then transported overland by rail. During the rail shipment, the molds broke through the floor of the railroad car, fell on the tracks below and caused a derailment of the train. Under standard CGL analysis, that event qualifies as an occurrence which results in property damage. It does not matter that the cause of action was for contractual breach of warranty rather than negligence. The label on the cause of action is irrelevant.

The next step in the analysis is whether the exclusion for "assumption of liability under contract" applies, commonly (but erroneously) referred to as the contractual liability exclusion. It does. The exclusion, however, is subject to an exception, if the assumption of liability is in an "insured contract."

Now, before we get to how the Court determined that the bill of lading did not constitute an insured contract, let's take a quick detour to see how contractual indemnity provisions typically trigger insurance coverage. As set out above, the damages sought have to be covered by an insuring agreement in the policy, either bodily injury, property damage, personal injury or advertising injury, or errors and omissions that occurred during the policy period. Second, the damages have to be the result of an occurrence. If those elements are met, there is no requirement that the cause of action be negligence. Biblically speaking, this is where the right hand "giveth." Then, the policy must be examined to see if any exclusions apply, or the left hand "taketh" away. If there weren't coverage in the first place, then the policy would not need to have an exclusion. In the instance in which an

exclusion has an exception, the policy restores the coverage that existed under the insuring agreement, but was carved out by the exclusion.

When you dissect the Contractual Liability exclusion, the "insured contract" exception and the definition of "insured contract," it reveals that an insured contract has nothing to do with whether the insured assumes liability for anything other than its own negligence. In fact, what liability the insured assumes is not the operative question. The determination of whether there is coverage is dependent upon the nature of the indemnitee's liability to the third party, not the nature of the insured's liability to the indemnitee.

An insured contract is one in which the Insured (the Indemnitor) assumes liability of another (the Indemnitee) that would be imposed on the Indemnitee by law (in the absence of a contract) for bodily injury or property damage to a third party. Clearly, one must look at whether the Indemnitee's liability was imposed by law, such as common law negligence or by statute, rather than contract. The question is not whether the Indemnitor assumed liability for something other than its own negligence, but rather whether the Indemnitee was liable to others.

Here's a diagram for how to dissect the definition:

"That part of any other contract ... under which **you**	You	Insured= Indemnitor
assume the	Assume	promise to Indemnify for Breach of Warranty
tort liability of	Tort Liability	"a liability that would be imposed by law in the absence of any contract or agreement"
another party to pay for bodily injury or property damage to a	Another Party	Indemnitee
third person or organization."	Third Party or Organization	Claimant suing the Indemnitee

So, now let's go back to Plano's plight. Plano, as indemnitor, promised to indemnify K-Line for its liability to third parties, if K-Line became liable to pay damages for bodily injury or property damage of a third party. K-Line became liable to other shippers for damage to their property presumably under a negligence theory, which qualifies as liability "imposed by law in the absence of any contract or agreement. Why wasn't Plano's promise to indemnify K-Line an insured contract?

Here's how the Illinois court incorrectly answered it: "because defendant (the Insured) is liable only for its own breach of warranty, it has not assumed liability for K-Line's negligence." The Virginia Surety opinion held that a contract in which the insured agrees to indemnify against the insured's own negligence is not an insured contract. Wrong and irrelevant.

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