STATE OF MICHIGAN

COURT OF APPEALS

HERITAGE MUTUAL INSURANCE COMPANY,

Plaintiff-Appellee,

v

EAST BANK ASSOCIATES LIMITED PARTNERSHIP, as Assignee of FRAME ENGINEERING COMPANY, INC.,

Defendant-Appellant,

and

TRANSCONTINENTAL INSURANCE COMPANY and CNA INSURANCE GROUP OF COMPANIES,

Defendants-Appellees.

UNPUBLISHED
February 19, 1999

No. 193311
Kent Circuit Court
LC No. 93-079841 CK

HERITAGE MUTUAL INSURANCE COMPANY,

Plaintiff-Appellant,

v

EAST BANK ASSOCIATES LIMITED PARTNERSHIP, as Assignee of FRAME ENGINEERING COMPANY, INC., TRANSCONTINENTAL INSURANCE COMPANY, and CNA INSURANCE GROUP OF COMPANIES,

Defendants-Appellees.

No. 193323
Kent Circuit Court
LC No. 93-079841 CK

Before: MacKenzie, P.J., and Holbrook, Jr., and Saad, JJ.

PER CURIAM.

Plaintiff Heritage Mutual Insurance Company (hereinafter "plaintiff") and defendant East Bank Associates Limited Partnership (hereinafter "East Bank") appeal as of right from the circuit court's order denying plaintiff's motion for summary disposition and granting defendant Transcontinental's (hereinafter "Transcontinental") and defendant CNA Insurance Group of Companies' (hereinafter "CNA") cross-motions for summary disposition.[1] East Bank also appeals from the circuit court's order denying plaintiff's and East Bank's motions for reconsideration. We reverse and remand.

Frame Engineering Company, Inc. (hereinafter "Frame") is a Wisconsin corporation with its principal place of business in Wisconsin. In August 1990, Frame entered into a subcontract with Citadel Corporation (hereinafter "Citadel"), a North Carolina corporation with its principal place of business in Georgia. Citadel was the general contractor overseeing the construction of the Eastbank Waterfront Towers, a thirty-three story commercial high-rise located in Grand Rapids. The building is owned by East Bank, a Michigan limited partnership with its principal place of business in Michigan. Frame manufactured the exterior wall panels used in the construction of the high-rise. Installation of these panels began during the summer of 1990 and continued into the early months of 1991.

During the summer of 1991, apparently after a series of thunderstorms, East Bank noticed that water was leaking into the interior of the building causing damage throughout. The apparent source of these leaks was a pervasive sealant failure at the horizontal and vertical joints between the exterior wall panels. After the joints between the panels were resealed, East Bank again noticed water leaking into the interior of the building after heavy rains in the summer of 1992. The 1992 leaks were apparently caused by cracks penetrating the exterior wall panels themselves. During the period when the first leaks were observed, Frame was insured by plaintiff (in a policy running from January 5, 1991 through January 4, 1992). During the occurrence of the second leaks, Frame was insured under a policy issued by CNA (running from January 5, 1992 through January 4, 1993).

We review motions for summary disposition de novo in order to determine "whether the moving party was entitled to judgment as a matter of law." *Stehlik v Johnson (On Rehearing)*, 206 Mich App 83, 85; 520 NW2d 633 (1994). Although the circuit court did not specify in its order the grounds on which it was granting Transcontinental and CNA summary disposition, it is clear from the record that the order was based on MCR 2.116(C)(10).

> MCR 2.116(C)(10) permits summary disposition when, except for the amount of damages, there is no genuine issue concerning any material fact and the moving party is entitled to damages as a matter of law. A court reviewing such a motion must consider the pleadings, affidavits, depositions, admissions, and any other documentary evidence in favor of the opposing party and grant the benefit of any reasonable doubt to the opposing party. [*Id.*]

In its opinion, the circuit court stated that it was granting summary disposition to Transcontinental and CNA on the basis of the "known risk"[2] and "loss in progress"[3] doctrines:[4]

> This Court does not feel that it has to make a determination as to whether or not there were two . . . separate occurrences. The loss in question[--]. . . the damage to the interior of the building because of defects or problems with the shell of the building[--]was in progress in January 1992 when the insured sought and received coverage from CNA. The October 21, 1991 report of SME put Frame on notice of problems with the shell of the building and specifically put Frame on notice that panel cracks were observed. . . .
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> . . . . Furthermore, even at this time there was leaking doing damage to the interior of the building. . . . Whether the damage interiorly was caused by the caulking, by improper joints, by improper adhesion of the exterior shell to the frame of the building or because of the cracks, [is] in this Court's opinion immaterial. The loss which Frame seeks coverage for was the interior damage because of water coming through the exterior of the shell. That loss was in progress prior to the inception of the CNA policy on January 5, 1992. It was a loss [of] which Frame had knowledge. And it was a risk which was at that time known to Frame. This Court is of the opinion that Frame should have reasonably known and did reasonably know that the continued damage to the interior of the building would result from the cracking of the panels which was observed in 1991.

We disagree with the circuit court's conclusion that the specific source of the leaks is immaterial. While the resulting damage to the building was the same, we believe that the source of that damage is relevant to the issue of whether summary disposition was properly granted. Because the 1992 leaks were apparently caused by cracks in the exterior wall panels, the issue of Frame's knowledge of those cracks is central to the resolution of this appeal.

We also disagree with the circuit court's conclusion that the documentary evidence undeniably establishes that Frame either knew, or reasonably should have known, about the cracked panels when it contracted with CNA. The October 21, 1991 report referenced by the circuit court in its opinion was prepared by Soils and Materials Engineering Inc. ("SME") for Citadel. The majority of this report focuses on the observed failure of the caulking/sealant that was placed in the horizontal and vertical joints between the panels. However, the SME report also made the following observation: "During the reviews, we have observed numerous panels with vertical cracking that travel from panel to panel, in the same vertical plane. The observed cracks are hairline . . . . Our concern is the possible cracking reflecting through the membrane or weakening of the membrane at the crack locations." As the deposition of John Zarzecki (an employee of SME assigned to the Eastbank project) makes clear, the vertical cracks observed and referenced in the report were cracks in the building's decorative brick facing, not cracks to the panels themselves. In fact, there is no indication in the October 21, 1991 report that the waterproof membrane of the panels had actually been breached as of that date. That the panels were not cracked in 1991 is further evidenced by the affidavit of Tage Carlson. Carlson works for Packer Engineering, which was hired by East Bank to examine the exterior panels after the second

major leaks occurred in 1992. In his affidavit, Carlson opined that the exterior cracks that caused the interior leaks in 1992 "were not present in 1991." On the other hand, there was also evidence that by November 1991, remedial measures were taken, including repairs to the panels' waterproof membrane to prevent moisture from entering the interior side of the panels near their fasteners. This suggests knowledge that the waterproof membrane had been breached, causing leakage, before the contract of insurance with CNA became effective.

We conclude, therefore, that a genuine issue of fact exists regarding Frame's knowledge that the panels themselves could fail at the time it contracted for insurance with CNA. When viewed in a light most favorable to plaintiff, we believe that the documentary evidence of record establishes that reasonable minds could differ as to whether plaintiff had foreknowledge of an immediate threat to the integrity of the panels.[5] Further, although the October 21, 1991 report warned Frame of the *possibility* of cracking, we do not believe that this establishes as a matter of law that Frame either knew or should have known that it was *probable* that the panels would crack.[6] Accordingly, we reverse the grant of summary disposition in favor of Transcontinental and CNA.[7]

We also agree with appellants' assertions that: (1) the circuit court erroneously ruled that Transcontinental and CNA had no duty to defend Frame; and (2) because Transcontinental and CNA had a duty to defend, they are precluded from raising any coverage defenses. As the circuit court correctly concluded, according to the precepts of the "most significant relation" test, Wisconsin law applies on the question of whether Transcontinental and CNA had a duty to defend. *Chrysler Corp v Skyline Industrial Services, Inc*, 448 Mich 113, 121-122; 528 NW2d 698 (1995).

In Wisconsin, "[t]he duty to defend is triggered by the allegations contained within the four corners of the complaint." *Newhouse v Citizens Security Mutual Ins Co*, 501 NW2d 1, 5 (Wis, 1993).

> In return for the premiums paid by the insured, the insurance company assumes the contractual duties of indemnification and defense for claims described in the policy.... An insurance carrier's duty to defend insured in a third-party suit is broader than its duty of indemnification and ... depends on the nature of the claim and has nothing to do with the merits of the claim. If there is any doubt about the duty to defend, it must be resolved in favor of the insured. *If the insurance company refuses to defend, it does so at its own peril*. [*Elliott v Donahue*, 485 NW2d 403, 407 (Wis, 1992)(citations omitted) (emphasis added).]

Additionally, under Wisconsin law

> [a]n insurer has several options available when it wants to raise a coverage issue and retain its right to challenge coverage. One option requires the insurer to request a bifurcated trial on the issues of coverage and liability or a declaratory judgment on the coverage issue. Another option requires the insurer to give the insured notice of the insurer's intent to reserve its coverage rights. This allows the insured the opportunity to a defense not subject to the control of the insurer although the insurer remains liable for

> the legal fees incurred. [*Jacob v West Bend Mutual Ins Co*, 553 NW2d 800, 805 (Wis App, 1996) (citations omitted).

An insurer's duty to the insured is not suspended, however, pending the resolution of the coverage issue. *Newhouse, supra* at 6; *Barber v Nylund*, 461 NW2d 809, 812 (Wis App, 1990).

In this case, Citadel's claim against Frame was that Frame's negligence caused property damage - the type of claim covered by the CNA policy. Because the "nature of the claim", *Elliott, supra*, p 407, fell within the contract of insurance, Transcontinental and CNA had a duty to defend. Further, because they failed to represent Frame's interests at the February 1995 settlement conferences even though the issue of coverage remained unresolved, *Newhouse, supra* at 6; *Barber, supra* at 812, Transcontinental and CNA waived any coverage defense. *Benjamin v Dohm*, 525 NW2d 371, 377 (Wis App, 1994); *Professional Office Buildings, Inc v Royal Indemnity Co*, 427 NW2d 427, 432 (Wis App, 1988). Thus, even if the loss in progress doctrine were applicable, Transcontinental and CNA waived defenses to coverage, including the defense of loss in progress. Given defendants' breach of their duty to defend and their waiver of the loss in progress defense, plaintiff's motion for summary disposition should have been granted.

Reversed and remanded for entry of an order granting summary disposition in favor of plaintiff, and for determination of damages sustained by plaintiff as a result of Transcontinental's and CNA's failure to defend. We do not retain jurisdiction.

/s/ Barbara B. MacKenzie
/s/ Donald E. Holbrook, Jr.
/s/ Henry William Saad

[1] The circuit court dismissed with prejudice all claims against Transcontinental and CNA.

[2] "'For the known risk doctrine, the relevant question is whether the insured knew or reasonably should have known there was substantial probability of a loss before the policy period began.'" *Inland Waters Pollution Control, Inc v National Union Fire Ins Co*, 783 F Supp 325, 328 (ED Mich, 1992), quoting *Central Quality Services Corp v Ins Co of North America*, 189 WL 550806 *17 n 13 (ED Mich, 1989), rev'd on other grounds *Inland Waters Pollution Control, Inc v National Union Fire Ins Co*, 997 F2d 172 (CA 6, 1993) (hereinafter *Inland Waters II*).

[3] The loss in progress doctrine applies "'only where the insured is aware of a threat of loss so immediate that it might fairly be said that the loss was in progress and that the insured knew it at the time the policy was issued and applied for.'" *South Macomb Disposal Authority v American Ins Co*, 225 Mich App 635, 693; 572 NW2d 686 (1998), quoting *Inland Waters II, supra* at 178.

[4] Although the circuit court stated that in its opinion the loss in progress doctrine was "the more accurate application" under the circumstances, it ultimately did find that summary disposition in favor of Transcontinental and CNA was justified under both doctrines.

[5] Given that such a reasonable difference of opinion exists, the loss of progress doctrine is inapplicable. Therefore, we need not address the question of whether Michigan courts should specifically adopt the loss in progress doctrine. See *South Macomb Disposal, supra* at 695.

[6] Therefore, we need not address the question of whether Michigan courts should specifically adopt the known risk doctrine.

[7] Given this decision, we need not address the argument that summary disposition was premature given that discovery was suspended and incomplete at the time the circuit court order was entered.