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NJ Justices Weigh Edge For Builders In Defect Coverage Suits

By **Jeff Sistrunk**

Law360, Los Angeles (November 5, 2015, 9:43 PM ET) -- New Jersey's highest court has agreed to decide whether damages resulting from a subcontractor's defective work on a condominium complex triggered an insurer's duty to defend the general contractor, and attorneys say a ruling favoring the condo association could eliminate an easy out for carriers in construction defect coverage suits.

The New Jersey Supreme Court on Tuesday granted certification to tackle the Appellate Division's July ruling that consequential damages to the common areas of a condo complex and unit owners' property caused by subcontractors' defective work are "property damage" and an "occurrence" under the general contractor's commercial general liability policy.

In the case, plaintiff Cypress Condominium Association Inc. sought coverage from the general contractor on the complex, Adria Towers LLC, for consequential damages caused by the subcontractors' faulty workmanship.

The appeals court's decision changed the landscape for construction defect coverage litigation in New Jersey and brought the state into line with a majority of jurisdictions that have considered the issue of whether general contractors can seek a defense from their insurers for claims of allegedly defective work performed by subcontractors, experts say. The questions at hand had been "hotly litigated" at the trial court level, resulting in "a lot of chaos" for several years, said Lowenstein Sandler LLP partner Lynda Bennett.

"It will be very helpful for the New Jersey Supreme Court to state once and for all whether faulty workmanship is an occurrence, and if a general contractor can show property damage if work is performed by subcontractors," Bennett said.

According to attorneys, the Cypress Point decision negated insurers' ability to rely upon the faulty workmanship exclusion in contractors' policies and a handful of prior decisions to prevail on summary judgment in coverage disputes. If the New Jersey Supreme Court affirms the lower court, insurers looking to dodge coverage for construction defect claims will have to determine the precise source and extent of damages, experts say.

"Insurers will have a harder time getting out of claims, because a more fact-specific inquiry will be required," said Sherilyn Pastor, leader of McCarter & English LLP'sinsurance coverage group. "Whether or not there is coverage will depend on whose work was involved, and what direct and consequential damage it caused."

The Appellate Division emphasized in its ruling that its conclusion that the condo association had met the definitions of property damage and occurrence in Adria Towers' policies didn't mean there was automatically coverage for the claimed damages. Attorneys pointed out that, in the event of a New Jersey high court decision in favor Cypress Point, insurers will still retain their ability to raise various exclusions to contest coverage.

"What Cypress Point didn't do ... is take away the insurers' option to rely on several business risk exclusions in the general liability policy," said Michael S. Savett, counsel in the Princeton, New Jersey, office of Hill Wallack LLP. "I don't expect that aspect of the decision to change. However, if the Supreme Court rules in favor of insurance carriers, that would turn back the clock on whether these types of claims can constitute an occurrence."

In the case, Cypress Point sued Adria Towers and its insurers and subcontractors. The condo association asserted that the subcontractors' faulty workmanship caused consequential damages to common areas and unit owners' property, and that those damages were therefore covered by Adria Towers' policies.

However, a trial judge determined that there was no property damage or occurrence as required to trigger coverage, and ruled in favor of the insurers.

In reversing the lower court, the Appellate Division found that the consequential damages flowing from the subcontractors' shoddy work met the policies' definition of property damage, as they were clearly "physical injury to tangible property." Moreover, the damages equated to an occurrence, which is defined in the policies as an unexpected or unintended "continuous or repeated exposure to substantially the same general harmful conditions," according to the appellate opinion.

The appellate court also agreed with the condo association that the New Jersey Supreme Court's 1979 decision in Weedo v. Stone-E-Brick Inc. and the Appellate Division's 2006 ruling in Firemen's Insurance Co. of Newark v. National Union Fire Insurance Co. involved different facts and policies than the instant case and were therefore distinguishable.

"Weedo and Firemen's are cases that insurance carriers had relied on for years. That was largely because the decisions supported the position that there was no occurrence and no coverage without even reaching the policy exclusions," Savett said.

Weedo and Firemen's both interpreted the 1973 standard CGL form issued by Insurance Services Office Inc. The Cypress Point case, however, dealt with the 1986 iteration of the CGL form, which added an exception to the "your work" exclusion for work performed on the insured's behalf by a subcontractor.

"Until Cypress Point, there was no decision in Jersey interpreting the business risk exclusion with a subcontractor exception," Bennett said.

The Appellate Division further rejected the trial court's reliance on the Third Circuit's 2010 unpublished opinion in Pennsylvania National Mutual Casualty Insurance Co. v. Parkshore Development Corp., which cited Firemen's for the position that work performed by a contractor or subcontractor that damages the general contractor's work is not an occurrence.

The Cypress Point decision was significant to New Jersey practitioners in that "it distinguishes, clarifies and corrects earlier decisions cited by insurers," according to Pastor.

"Gone are the days when an insurer can prevail on a claim simply by pointing to Penn National and a faulty workmanship exclusion without consideration of its own policy's subcontractor exception to the exclusion and the involved factual circumstances," Pastor said.

The ruling "narrowed the field of issues on the defense side of things" in construction defect coverage disputes, Bennett said.

"The most important upshot in Cypress Point is that insurers should be defending these claims alleging faulty workmanship," she said.

Pastor noted that many general contractors use single-purpose entities for their construction projects, and those vehicles sometimes have limited financial resources to meet claims. The Appellate Division ruling gives those who are harmed by a subcontractor's faulty workmanship a way to access the general contractor's insurance, she said.

"Where the general contractor has purchased insurance protection, its insurance policy now offers it, and those harmed by its subcontractors' faulty workmanship, an important financial asset to meet claims," Pastor said.

David E. Wood of Anderson Kill PC said it is difficult for him to imagine the New Jersey Supreme Court "sticking its neck out and siding with an insurance company argument that, no matter what, faulty workmanship is never covered even if it causes accidental property damage." A ruling upholding the Appellate Division would be a win for construction industry policyholders in the state, attorneys say.

"If the Supreme Court affirms, it will certainly validate the position that the policyholder bar and general contractor community have been advocating for years," Savett said. "However, the fact that the court has granted leave to appeal will give the policyholders some concern that the court might go back to the way things were prior to the Appellate Division decision."

A reversal could cut off general contractors' access to coverage for damages stemming from subcontractors' defective work, according to experts.

"Particularly from the policyholders' perspective, a reversal would be devastating for general contractors," Bennett said. "If they don't get coverage when they're being held vicariously liable for work by subs, what's the purpose of buying general liability coverage? That would take away insurance they've paid a lot of money for."

Until the New Jersey high court decides the case, general contractors and insurers embroiled in pending construction defect coverage litigation in the state will be left in limbo, attorneys say.

"It will be interesting to see whether the pendency of a definitive ruling, which is probably a year away, will cause policyholders and insurers in the meantime to settle their differences or hold out until this issue is resolved," Savett said.

--Editing by Katherine Rautenberg and Philip Shea.
