August 5, 2016

Practice Group:

Insurance Coverage

New Jersey Supreme Court Gives Supreme Win to Policyholders

By Frederic J. Giordano, Robert F. Pawlowski, and Denise N. Yasinow

Yesterday, the Supreme Court of New Jersey unanimously affirmed the Appellate Division's holding that consequential damages caused by a subcontractor's faulty workmanship constitute "property damage" and an "occurrence" under the 1986 Insurance Services Office, Inc. ("ISO") form commercial general liability ("CGL") insurance policy. This holding is welcome news to real estate developers, general contractors, and commercial policyholders who may seek coverage for damage caused by the faulty work of their subcontractors.

In *Cypress Point Condominium Association, Inc. v. Adria Towers, LLC*, *et. al.,*[1] plaintiff, a condominium association, brought an action against the association's developer and various subcontractors. The developer had served as the general contractor on the condominium project and hired the subcontractors to perform all construction work. Plaintiff alleged that the subcontractors improperly installed roofs, gutters, brick facades, exterior insulation and finishing system siding, windows, doors, and sealants (the "faulty workmanship"). The faulty workmanship caused damage to the interior structures, common areas, and unit owners' property. When one of the developer's insurers declined coverage, plaintiff amended its complaint to add the insurer, seeking a declaration that its CGL policies, which were written on the 1986 ISO standard form, covered plaintiff's claims against the developer. That insurer impleaded a second insurer, and both insurers moved for summary judgment. While the trial court held that there was no "property damage" or "occurrence" as required by the policies to trigger coverage, the Appellate Division reversed, coming to the opposite conclusion.

On appeal once more, the Supreme Court affirmed the Appellate Division. Before turning to the merits of the appeal, Justice Solomon, writing for a unanimous Court, discussed the general principles governing the interpretation of insurance policies, the history of CGL policies, and relevant caselaw pertinent to interpreting CGL policies. In particular, the Court distinguished the seminal New Jersey decisions of *Weedo*[2] and *Firemen's Fund*[3] because they interpreted the 1973 ISO standard form policy rather than the 1986 ISO standard form policy. Instead, the Court found instructive cases from Florida's highest court[4] and the Fourth Circuit[5] that interpreted the 1986 ISO standard form policy and represented "a strong recent trend in the case law of most federal circuit and state courts interpreting the term

---

[1] 2016 N.J. LEXIS 847 (N.J. Aug. 4, 2016).

[2] *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233 (1979) (finding CGL policies did not indemnify insureds where the claimed damages were the cost of correcting the alleged defective work).

[3] *Firemen's Ins. Co. of Newark v. Nat'l Union Fire Ins. Co.*, 387 N.J. Super. 434 (App. Div. 2006) (holding that claims against an insured general contractor for the cost of replacing defective work itself did not qualify as covered "property damage" caused by an "occurrence").

[4] *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So. 2d 871 (Fla. 2007).

[5] *French v. Assurance Co. of Am.*, 448 F.3d 693 (4th Cir. 2006).

'occurrence' to encompass unanticipated damage to nondefective property resulting from poor workmanship."[6]

The Court then turned to the merits of the appeal and relied on a three-step analysis.

As the first step, the Court examined plaintiff's claims to ascertain whether the policies provided an initial grant of coverage. The Court reasoned that "post-construction consequential damages resulted in loss of use of the affected areas by [plaintiff's] residents" and therefore qualified as "[p]hysical injury to tangible property including all resulting loss of use of that property" as defined by the policies.[7] Therefore, plaintiff's consequential damages were covered "property damage" under the terms of the policies. The Court then found that there was an "occurrence" under the policies, which defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The Court reasoned that "[i]n any event, under our interpretation of the term 'occurrence' in the policies, consequential harm caused by negligent work is an 'accident.' Therefore, because the result of the subcontractors' faulty workmanship here . . . was an 'accident,' it is an 'occurrence' under the policies . . . ."[8]

For the second and third steps, the Court considered whether any policy exclusion precluded coverage and, if so, whether an exception to the pertinent exclusion applied to restore coverage. Here, the policies contained "numerous exclusions eliminating coverage for a variety of business risks including the cost of repairing damage to the contractor's own work — the 'your work' exclusion."[9] While the Court acknowledged that the "your work" exclusion "would seem to eliminate coverage for the water damage to the completed sections of" the condominium, the Court noted that the policies also contained an exception for the work of a subcontractor.[10] This "subcontractor exception" serves to "narrow[] the exclusion by expressly declaring that it does not apply 'if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.'"[11] Thus, the Court reasoned that because the water damage was alleged to have arisen out of faulty workmanship performed by subcontractors, it was a covered loss.

Importantly, the Court noted the standard ISO form evolved to include the subcontractor exception to the "your work" exclusion. Specifically, it "resulted both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of the insurers that the CGL [policy] was a more attractive product that could be better sold if it contained this coverage."[12] Moreover, the "insur[ance companies] here chose not to negotiate away the subcontractor exception and instead issued the developer a series of

---

[6] *Cypress Point*, 2016 N.J. LEXIS 847, at *33–*34 (quoting *Greystone Constr. v. Nat'l Fire & Marine Ins. Co.*, 661 F.3d 1272, 1282–83, 1286 (10th Cir. 2011)) (internal punctuation omitted).

[7] *Cypress Point*, 2016 N.J. LEXIS 847, at *36.

[8] *Id.* at *42.

[9] *Id.* at *43 ("the 'your work' exclusion precludes coverage under the policies for 'property damage' to 'your work' arising out of it or any part of it.").

[10] *Id.* at *43–*44.

[11] *Id.* at *44.

[12] *Id.* (quoting Christopher C. French, Construction Defects: Are They 'Occurrences'?, *47 Gonz. L. Rev. 1*, 8-9 (2011–12)).

New Jersey Supreme Court Gives Supreme Win to Policyholders

1986 ISO standard form CGL policies which explicitly provide coverage for property damage caused by a subcontractor's defective performance."[13]

In all, the Supreme Court's decision in *Cypress Point* is a significant win for New Jersey policyholders. As referenced by the Court, New Jersey has now joined the "strong recent trend" in holding that construction defects causing consequential damage unambiguously give rise to an "occurrence" and "property damage."

Authors:

Frederic J. Giordano
frederic.giordano@klgates.com
+1.973.848.4035

Robert F. Pawlowski
robert.pawlowski@klgates.com
+1.973.848.4032

Denise N. Yasinow
denise.yasinow@klgates.com
+1.973.848.4036

[13] *Id.* at *46.