

July 13, 2015

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## New Jersey Developer Wins on “Occurrence” and “Property Damage”; Appellate Division finds Subcontractors’ Faulty Construction within Insuring Agreement; *Parkshore* Abrogated

By Frederic J. Giordano, Robert F. Pawlowski and Stephanie S. Gomez\*

The Superior Court of New Jersey, Appellate Division, has issued a very important decision for real estate developers and general contractors whose insurance companies have reserved rights or denied coverage for damage caused by the faulty work of their subcontractors. In *Cypress Point Condominium Association, Inc. v. Adria Towers, LLC*, (“Cypress”),<sup>1</sup> the Court held that unexpected and unintended consequential damage caused by a subcontractor’s faulty workmanship constitutes “property damage” caused by an “occurrence” under a commercial general liability (“CGL”) insurance policy. The decision nullifies the Third Circuit’s contrary opinion in *Pennsylvania National Mutual Casualty Insurance Co. v. Parkshore Development Corp.*,<sup>2</sup> much to the chagrin of insurance companies who have come to rely heavily on the unpublished decision to support countless coverage denials.

The Court found that *Parkshore* incorrectly relied on inapposite precedent interpreting a distinguishable, earlier version of the standard coverage form. In this case (and in *Parkshore*), the plain language of the policy,<sup>3</sup> follows the Insurance Services Office, Inc.’s (“ISO”), 1986 standard CGL form (the “1986 ISO form”). To the contrary, the policies at issue in *Weedo v. Stone-E-Brick, Inc.*,<sup>4</sup> and *Firemen’s Insurance Co. of Newark v. National Union Fire Insurance Co.*,<sup>5</sup> the two opinions relied upon by the *Parkshore* court, followed ISO’s 1973 standard CGL form (the “1973 ISO form”). Those cases are readily distinguishable. The *Cypress* Court has now made clear that consequential damages flowing from defective work differ from the costs associated with replacing the defective work, and a developer could reasonably expect that the subcontractor’s faulty workmanship would be treated differently than the work of the general contractor.

In *Cypress*, Plaintiff, a condominium association, brought an action against the association’s developer, Adria Towers, L.L.C. (the “developer”), the developer’s insurers, and various subcontractors. The developer served as the general contractor on the condominium project and hired the subcontractors to perform all the construction work. Plaintiff sought coverage from the insurers under the developer’s CGL policy for consequential damages caused by the subcontractors’ defective construction. According to the Plaintiff, the subcontractors improperly installed the roof, flashing, gutters and leaders, brick and EIFS facade, windows,

<sup>1</sup> No. A-2767-13T1 (N.J. Super. Ct. App. Div. July 9, 2015); \_\_\_ N.J. Super. \_\_\_ (App. Div. 2015).

<sup>2</sup> 403 Fed. Appx. 770 (3d Cir. 2010).

<sup>3</sup> The Court notes that the “insurers’ policies contain the same pertinent language”; therefore, the Court refers to the pertinent CGL policies in the singular, the “policy.”

<sup>4</sup> 81 N.J. 233 (1979).

<sup>5</sup> 387 N.J. Super. 434 (App. Div. 2006).

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doors, and sealants (the “faulty workmanship”). The faulty workmanship caused damage to the interior structures, common areas, and unit owners’ property. Some units even experienced damage from water infiltration. The trial court, persuaded by the Third Circuit’s opinion in *Parkshore*, held that there was no “property damage” or “occurrence” as required by the policy to trigger coverage. On appeal, the sole issue before the Court was whether consequential damages to the common areas and to the unit owners’ property, caused by the faulty workmanship, constituted “property damage” caused by an “occurrence” under the policy.

The Court first examined the plain language of the policy. According to the Court, the damages caused by the subcontractors’ faulty construction clearly constituted “physical injury to tangible property,” as defined by the policy, because the resulting damage was to the common areas and unit owners’ property. The Court further found that the faulty workmanship constituted an “occurrence,” because it could not “reasonably believe[] that the subcontractors either expected or intended for their faulty workmanship to cause ‘physical injury to tangible property.’” Thus, the Court reasoned “the consequential damages here amount to ‘property damage’ and an ‘occurrence.’”

Having conducted the initial threshold analysis, the Court next addressed whether the trial court erroneously applied the holdings in *Weedo* and *Firemen’s* to determine whether there was “property damage” and an “occurrence.” The Court concluded that “those cases are distinguishable because they (1) involved only replacement costs flowing from a business risk, rather than consequential damages caused by defective work; and (2) interpreted different language than the policy language in this appeal.” In *Weedo*, the court interpreted the 1973 ISO form and held that the insurance coverage excluded the damages claimed because the cost of correcting the defect itself is considered a “business risk” and uninsurable. By contrast, here, “the consequential damages are not defective-work damages[, and] ... are distinct from the cost of correcting the work itself.” Similarly, the Court found the decision in *Firemen’s* did not apply, because the damages alleged there were related solely to replacing the construction defect. The Court emphasized that “the consequential damages [here] are ... not the cost of correcting the defective work, such as the cost of replacing the stucco in the *Weedo* case or replacing the firewalls as in *Firemen’s*, but rather the cost of curing the ‘property damage’ arising from the subcontractors’ faulty workmanship.”

The Court also based its “holding in part on the developer’s reasonable expectation that, for insurance risk purposes, the subcontractors’ faulty workmanship is to be treated differently than the work of a general contractor.” Two critical differences between the 1973 ISO form considered in *Firemen’s* and the 1986 ISO form used in *Cypress* illustrate why *Firemen’s* is distinguishable. First, the two forms define “occurrence” differently. The 1973 ISO form defines the term as “an accident ... which results in ... property damage neither expected nor intended from the standpoint of the insured.” In the 1986 ISO form, “occurrence” is defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” Thus, according to the Court, property damage “is not directly included in the policy’s definition of ‘occurrence,’ and *Firemen’s* is consequently not squarely on point.”

The second important difference between the ISO forms relates to the “Your Work” exclusion. In relevant part, the 1986 ISO form policy language states, “[t]his exclusion does

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not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.” The Court explained “the addition of the subcontractor’s exception is of critical importance when determining whether the subcontractors’ faulty workmanship causing consequential damages amounts to ‘property damage’ and an ‘occurrence’ under the policy.” The 1973 ISO form had no subcontractor exception, and courts were reluctant to separate a subcontractor’s faulty workmanship from that of the general contractor when defining the requisite “property damage” to trigger insurance coverage. But the exclusion is different now. The subcontractor exception, for insurance risk purposes, demonstrates that consequential damages caused by a subcontractor’s faulty workmanship are considered differently than property damage caused by a general contractor’s work. Therefore, a developer would “reasonably expect that consequential damages caused by the subcontractors’ faulty workmanship constituted ‘property damage’ caused by an ‘occurrence.’”

The Superior Court of New Jersey, Appellate Division’s decision in *Cypress* is significant to policyholders, as New Jersey has joined the current majority of states holding that construction defects causing consequential damages give rise to an “occurrence” and “property damage.” New Jersey policyholders should keep an eye on whether the carriers appeal the decision to the Supreme Court of New Jersey.

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