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New Jersey Courts Find Insurance Coverage for Subcontractors' Construction Defects

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The Appellate Division and the United States Court of Appeals for the Third Circuit, one day apart, each addressed the issue of insurance coverage for construction and other defects. The Appellate Division came out strongly for coverage. *Cypress Point Condominium Association, Inc. v. Adria Towers, LLC*, No. A-2767-13T1, __ N.J. Super. __ (App. Div. July 9, 2015).

In *Cypress*, Coverage for Consequential Damages Stemming from Faulty Work

The decision in *Cypress* involved an all too familiar fact pattern — faulty construction work caused water infiltration into a condominium development. In *Cypress*, the faulty workmanship was performed by subcontractors, and caused damage to common areas and individual units, including damage to drywall, insulation, wall finishes and flooring. The general contractor that hired the subcontractors sought coverage under its commercial general liability policies "for consequential damages caused by the subcontractors' defective work."

The *Cypress* court found that the cases on which the insurance company relied to deny coverage, *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233 (1979), and *Firemen's Insurance Co. of Newark v. National Union Fire Insurance Co.*, 387 N.J. Super. 434 (App. Div. 2006), did not govern. First, both cases involved situations where the sole damage was poor workmanship, not resultant consequential property damage. Second, both cases involved different policy language than did the insurance policy at issue in *Cypress*.

The *Cypress* court held that consequential damage to the common areas and unit owners' property constituted "property damage" and an "occurrence" as defined by the insurance policy. The court explained that consequential damage was not the cost incurred to repair the defective work, but rather "those additional damages to the common areas of the condominium building and the unit owners' property." The court held that "[t]he consequential damages are therefore not the cost of correcting the defective work, . . . but rather the cost of curing the 'property damage' arising from the subcontractors' faulty workmanship." The court found that there was a fundamental difference between the cost of correcting the poor workmanship itself, as compared to third-party consequential damage that resulted from the faulty workmanship.

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A New Look at Old Policies

The *Cypress* court analyzed the 1986 ISO form policy, and found cases, including *Weedo* and *Firemen's*, which construed the 1973 ISO form inapplicable. Both *Weedo* and *Firemen's* analyzed the 1973 standard commercial general liability form, or 1973 ISO form, which did not include a "significant exception" to the "your work" exclusion. However, in 1986, the standard exclusion language was changed by adding a "subcontractor exception": "This exclusion does 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 held that "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 court reasoned that the introduction of the subcontractor exception supports a finding that subcontractor's faulty workmanship, which caused consequential damage, would constitute "property damage" and an "occurrence."

In *USA Container* the Third Circuit Certified the Issue to the New Jersey Supreme Court

The Third Circuit in *Pennsylvania National Mutual Casualty Insurance Co. v. Parkshore Development Corp.*, 403 Fed. Appx. 770 (3d Cir. 2010), had ruled against such coverage. However, the Third Circuit now is revisiting its opinion. The *Travelers Property Casualty Company of America v. USA Container Co., Inc.*, No. 14-3685 (3d Cir. July 10, 2015). *USA Container* concerned a syrup distributor that hired USA Container to transfer product. USA Container subcontracted the work, and the subcontractor damaged the syrup. Travelers denied coverage, asserting there was no "occurrence." The court recognized that various jurisdictions have reached different holdings. The Third Circuit has now certified the question to the New Jersey Supreme Court.

Conclusion

The *Cypress* court held that the insuring agreement was triggered, although it did not reach the issue as to whether insurance coverage would ultimately exist, i.e., whether other policy exclusions would bar coverage. The Court also did not address whether coverage exists for the subcontractor's work, as opposed to consequential damages from that work. Still, the Appellate Division has already relied on *Cypress* in two subsequent cases. The opinions are nearly verbatim. *Belmont Condominium Association, Inc. v. Arrowpoint Capital Corporation*, No. A-4187-12T4, 2015 N.J. Super. Unpub. LEXIS 1749 (App. Div. July 21, 2015); *Bob Meyer Communities, Inc. v. James R. Slim Plastering, Inc.*, No. A-5581-12T1, 2015 N.J. Super. Unpub. LEXIS 1754 (App. Div. July 21, 2015).

The Appellate Division has now made clear that consequential property damage resulting from a subcontractor's poor workmanship does constitute "property damage" and an "occurrence" and is covered by liability insurance. Yet *Cypress*, like *USA Container*, may ultimately be settled by the New Jersey Supreme Court. Stay tuned.